Understanding innovation capability in micro enterprises

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Abstract
A conceptual model is developed with consideration of differences between different size enterprises to understand how innovation capability develops in micro enterprises. From three case studies, internal factors; i.e. leadership skills and participative culture, and external factors; i.e. customer engagement, networking and collaboration, have been identified as the key factors that underpin the development of innovation capability in micro enterprises.

Keywords: Innovation Capability, Micro Enterprises, Case Study

INTRODUCTION

Small and medium sized enterprises (SMEs) have an important place within all economies around the world, especially in developing countries with major employment and income distribution challenges. SMEs are the engine of growth, essential for developing competitive and efficient markets and reduction of poverty, particularly in developing countries (Fan 2003). SMEs are contributing to employment growth at a higher rate than larger firms. In the EU economy about 99.9% of the enterprises are SMEs of which 93% are micro enterprises (European Commission 2003). Micro companies are also a source of skilled workforce and have an important role in creating competitive industrial base (European Commission 2003).

Although large companies are important to the wellbeing of any economy, SMEs and particularly micro enterprises are critical to their economic development and prosperity. The well cited idiom *"from little acorns grow mighty oak trees"* reflects the critical impact of micro enterprises on future economic development (European Commission 2003). Innovation is also recognized as a key driver of economic development (Prajogo et al. 2013; Raymond et al. 2013), with many studies on how best to nurture and maximize innovative capabilities for sustainable impact on economic development. However, the development innovation capabilities in micro

enterprises is not well understood or researched. In this paper our objective is to explore how innovative capabilities develop in micro enterprises through three detailed case studies.

BACKGROUND

Innovation Capability

In today`s fast changing business environment, firms need to be innovative to create sustainable business and achieve competitive advantage. Innovation has an important role in a firm`s long-term success in the market. Baker et al. (2016); Prajogo et al. (2013); Saunila (2014) and Tie-jun and Jin (2006) emphasize the role of innovation as bringing competitive advantage to the companies. Björk and Magnusson (2009) argue that good innovation provides a competitive advantage over other competitors and deliver higher levels of customer satisfaction. Having differentiated product and being first in the market at the end of innovation process can be identified as some of the reasons of this success. Trott (2005, p.15) describes innovation as "the management of all the activities involved in the process of idea generation, technology development, manufacturing and marketing of a new (or improved) product or manufacturing process or equipment." Producing successful new products to the market brings acquiring continuity in the market (Dul and Ceylan, 2014). Many factors affect this success including market, new products' features, companies' innovation policies, working atmosphere which encourages employees for creating innovative ideas (Dul and Ceylan, 2014).

Innovation capability of a company is a factor that may affect the success or failure of its innovation. Innovation capability is defined by Hogan et al. (2011, p.1266) as "a firm's ability, relative to its competitors, to apply the collective knowledge, skills, and resources to innovation activities related to new products, processes, services, or management, marketing, or work organization systems, in order to create added value for the firm or its stakeholders." Saunila et al. (2014, p.136) define innovation capability as "a potential of an organization to create innovations continuously, and it consists of the determinants influencing an organization's capability to manage innovation." Innovation capability is explained by Adler and Shenhar (1990) in four aspects as;

- developing radical products to satisfy customer needs in the market;
- manufacturing these innovative products by utilizing suitable technologies;
- developing or adjusting innovative product and process technologies to satisfy foreseen future needs; and
- reacting quickly for unforeseen change in the market and opportunities.

As there are many other definitions of innovation and innovation capability, innovation capability is defined as ability to innovate successfully its products or processes to satisfy customer's needs and create competitive advantages. In this paper, innovation capability of different sized enterprises will be discussed, and innovation capability of micro enterprises will be analyzed in the research part.

According to Prajogo et al. (2013); Raymond et al. (2013) and Sadaba et al. (2016), the growth and profitability of all type of enterprises are based on their execution of innovation activities into market. This means innovation is important for all type of enterprises including large, small and medium sized enterprises (SMEs) and micro enterprises. According to the

different researches in the literature, different sizes of companies have both advantages and disadvantages in innovation capabilities.

Innovation Capability and Firm Size

Relationship between firm size and innovation capability has been extensively discussed in the literature. Larger firms may have some advantages in terms of accessible sources, experienced staff in innovation, globalization for their improved innovation capabilities (Prajogo et al. 2013). Romjin and Albaladejo (2002) suggest that the companies who serve to global markets are more successful in innovation which is supported by Efrat (2014) who explain that globalization is mainly dependent on innovation capabilities. Prajogo et al. (2013) state that size of the enterprises may have a positive effect on innovation in terms of having more Research & Development (R&D) staff in larger enterprises. Prajogo et al. (2013) assert that the size of the company does not have any influence on innovation orientation. However, it may have impact in terms of innovation performance of enterprises and innovation strategies (Prajogo et al. 2013). They emphasize that radical (exploration) innovation has more effect on performance of medium size enterprises, and that small, and incremental (exploitive) innovations have more effect on performance of small enterprises (Prajogo et al. 2013). Furthermore, Berends et al. (2014) state that the resource of small firms, especially financial and employee related resources are restricted for innovation compared to larger firms. Also, the position of the firm in the market limits its innovation capability (Berends et al. 2014).

Micro Enterprises

Definition of SMEs is different for each country based on their industrial and economic structure. Revenue, payrolls, total assets of enterprises, number of employee are key indicators used to differentiate micro, small, medium and large enterprises (European Commission 2014; SMEDP 2014; USITC 2014). The most common indicator is number of employees as illustrated in Table-1.

Table - 1 Definition of SMEs by countries

	Medium	***Small***	***Micro***
	Up to	Up to	Up to
USA	500	100	N/A
China	2000	300	N/A
EU	250	50	10
Australia	200	20	5
Turkey	250	50	10
UK	249	49	9

SMEs have specific characteristics that distinguish them from large corporations and that can of course change across different countries and cultures. According to the literature, SMEs are generally independent, multi-tasking, and cash-limited based on personal relationships and informality, as well as actively managed by the owners, highly personalized, largely local in their area of operation and largely dependent on internal sources to finance growth (Ates et al. 2013; Hudson-Smith and Smith, 2007; Moore and Manring, 2009; Vyakarnam et al. 1997).

However, the difference between micro enterprises and others are not so well defined. In this study, in order to clarify what makes micro enterprises different than others, we interviewed owners/managers of 16 micro manufacturing enterprises. The results are illustrated in Table 2. For the purpose of this study, micro enterprises are defined as manufacturing firms that have less than 20 employees.

Table – 2 Comparison of Large, SME and Micro enterprises (Inan and Bititci, 2015)

	Large	***SME***	***Micro***
	from literature		***from primary data***
Leadership	Leaders are more involved with strategic activities	Leaders are more involved with operational activities than strategic activities	Leaders are exclusively involved with operational activities
Management	Participative management	Mixture of empowered supervision and command and control	Command and control
Strategic Planning	Short and long term planning	Short term planning focus on niche strategies	Fire-fighting to survive
Organizational Structure	Hierarchical with several layers of management	Flat with few layers of management	Flat with one layer
System & Procedures	Formal control systems, High degree of standardization	Personal control Some degree of standardization and formalization	No procedures Low degree of standardization and formalization
Human Resources	Training and staff development is planned and is in large scale	Training and staff development is adhoc and small scale	Almost no training and staff development activities
Market and Customer Focus	Formal customer relationship Larger customer base	Formal-Informal customer relationship Limited customer base	Informal customer relationship Very limited customer base
Operational Improvement	Vast knowledge or understanding of operational improvement activities	Limited knowledge or understanding of operational improvement activities	No knowledge or understanding of operational improvement activities
Innovation	Innovation based on R&D	Innovation based on clusters and networking	Innovation based on technological improvement and customer needs
Networking	Extensive external networking Better understanding of support available from local government	Limited external networking Limited knowledge of funding and support available from local government	Very limited external networking No knowledge of funding and support opportunities

Theoretical Framework

Although previous researchers have conducted research to understand how firm size impacts on innovation capability and its development, they have largely ignored micro enterprises due to data gathering difficulties. Thus, a theoretical framework is developed to understand

development of innovation capability in micro enterprises. There are different classifications of innovation capability in literature and, internal and external sources of innovation are used at this research.

Internal and External Source of Innovation

Internal sources of innovation capability are identified in the literature as number of employees and their skills, employer`s work experience (engineering and management experience), educational background, professional background of founder/managers, leadership skills of employees, participative culture, working environment, resources of the enterprises (financial and technological), R&D effort, and continuous learning (Berends et al. 2014; Calantone et al. 2002; Denham and Kaberan, 2012; Dul and Ceylan, 2014; Schweitzer 2014; Madrid-Guijarro et al. 2009; Romjin and Albaladejo, 2002; Saunila 2014; Saunila and Ukko, 2014; Saunila et al. 2014; Tie-jun and Jin, 2006; Yang 2012). External sources of innovation capability are identified as external resources, financial support, intensity of networking with a variety of agents and institutions, geographical proximity advantages associated with networking, receipt of institutional support, external environment, government support, external partner, and external information (from suppliers, customers, industry associations and competitors) (Berends et al. 2014; Madrid-Guijarro et al. 2009; Romijn and Albaladejo, 2002; Saunila 2014; Saunila and Ukko, 2014; Tie-jun and Jin, 2006). Those factors are identified at large enterprises and SMEs. However, micro enterprises cannot develop different capabilities to support innovation capability as large and SMEs develop due to their resources (Inan and Bititci, 2015). Thus, our theoretical framework, illustrated in Figure 1, comprises internal factors such as leadership and participative culture and external factors such as customer engagement, networking and collaboration.

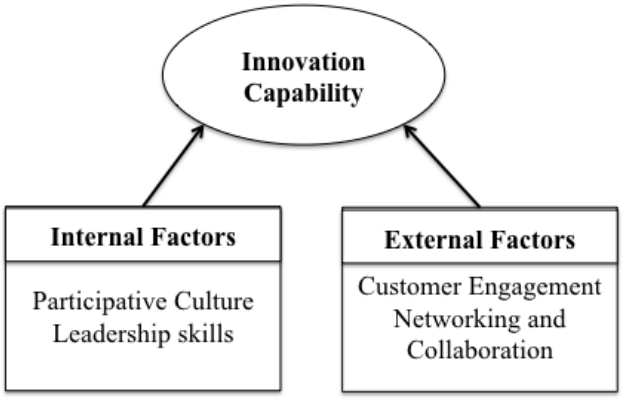

Figure – 1 Theoretical framework

Leadership and Participative Culture

According to Saunila and Ukko (2015), leadership skills may encourage the employee in terms of directing them to innovate instead of just ordering and instructing the team. Schweitzer (2014) supports the idea of participative leadership and explains that it influences significantly the innovation capability of a firm. Especially in smaller companies, it becomes more important. Because, smaller sized companies may get benefit from the participative leadership culture in the company that guides and encourages the employee for innovation and that is importantly more effective in smaller firms (Saunila and Ukko, 2014). The role of a leader in an innovative company is to create innovative atmosphere in the company. Innovative culture is emphasized by

Denham and Kaberan (2012, p.360) as important for innovation capability in terms of acquiring "a collaborative sensibility capable of open discussion, the means to confront challenges, conceive new ideas, build on those ideas, and finally make them tangible enough to move to market."

Dul and Ceylan (2014) emphasize the importance of working atmosphere for innovation capability, which is discussed in the literature by many scholars before. Their research on 103 companies supports that encouraging work environment increases the innovation performance and these companies produce more radical innovative products and their sales are significantly satisfactory (Dul and Ceylan, 2014). In the same vein, Saunila and Ukko (2014) confirm that supporting culture increases creativity and creative thinking and motivates the innovation capability of the employee. They have found that participatory leadership culture has significant influence on profitability of the company (Saunila et al. 2014). The interaction between NPD team and other employees help to the firm to be more creative to get market success (Dul and Ceylan, 2014).

Moreover, Saunila (2014) states that participative culture affects the working environment in terms of motivating and encouraging the employee to participate to innovation. However, contrary to the previous literature, she has found that participatory leadership has negative influence on financial performance of innovation due to causing lack of managing the firms while focusing on operations which in turn may damage the creation of innovative ideas (Saunila 2014).

Customer Engagement, Networking and Collaboration

Saunila (2014) states that by applying external knowledge from suppliers, customers, industry associations and competitors extend the innovative success because this communication may bring external information to the company. Tie-jun and Jin (2006) advocate that the communication with suppliers, customers and competitors and their contribution may increase the innovation capabilities of SMEs. External knowledge is found as a factor that has significant influence on profitability of the company (Saunila et al. 2014). Although, external contribution is supported by Saunila et al. (2014) and Tie-jun and Jin (2006), interaction with customers may show negative influence on innovation capability as seen in Romjin and Albaladejo's research (2002). On the contrary, communication with suppliers and service providers are determined as positively related to the innovation capability (Romjin and Albaladejo, 2002).

METHODOLOGY

In order to understand how innovation capabilities develop and evolve in micro Enterprises, case study methodology was followed. Case study research leads to new and creative insights, development of new theory, and has high validity with practitioners (Voss et al. 2002). Turkey is chosen as a case as micro enterprises have a vital role in Turkish economy and they perform lower than European micro enterprise – while European micro enterprises create 20.8% of value and creates 27.8% of employment within SMEs, Turkish micro enterprises create 8% of value and 34% of employment (Ozbek 2008). Three *growth oriented micro manufacturers* are chosen from Turkey and they have been observed for 9 months period. Data is collected via interviews, documents and direct observations.

DATA ANALYSIS

Firm A, is a furniture producer for 50 years. It's a family business and 8 full time and 1 part time workers are employed. They produce different type of furniture such as classic, modern or customized. Innovation and product development capability is a key capability for firm due to they are in fast changing market place. Sources of innovation capability are identified as customer requests, new materials and production techniques, employee ideas, and owner ideas. Customers bring new product ideas to business. Owner emphasizes the importance of customers as *"Our customers scan different sources to find best choice for their home. Thus, they can bring new type of furniture. For example, we produce our first modular teenage room based on a customer demand. It was difficult for us to find assembly materials at first but we succeed to deliver it on time as it is requested. Then, I begin to offer modular furniture for new customers."* Furthermore, their production site is in a furniture production area and they have good relationship with other. When a new machine or material is used by other manufacturer, they are able to learn about that machine and material. By this way, last three years they introduce new types of products. Internally, their experienced employees are another source for innovation. Employees find new solutions for customized products with their experience. Operation manager states that *"our main strength is that we can produce highly customized products with innovative solutions".* Furthermore, owner also motivates his employees to generate new ideas and he shares his responsibilities with employees to create slack time for scanning activities.

Firm B produces metal accessories for door and window production for 15 years. It is a family business and employs 8 full time employees. They have increased their product range since the first day and still continue to invest for new products. Their customers force them to produce new type of products. For instance, manager gives an new product example *"door mechanisms was right or left side and our customers was ordering two different products. We produced first double side door mechanism so our customers can use our new product for both right or left side doors."* Moreover, they received 5 different funds from government support organizations (GSOs) to improve their machinery capabilities within last 4 years. They also work with a local university to design new products. As a result, their networking and collaboration activities have positive impact on development of innovation capability. On the other hand, internal source of innovation is not developed at the firm. Employee participation is not encouraged. Hence, employees do not share or generate new ideas. However, three brothers (owners) share responsibility and manager has slack time for searching and scanning new opportunities.

Firm C, produces carton boxes for the local market since 2001. The firm is founded by two entrepreneurs. They hire 19 full-time workers. Different sources of innovation are identified. Firstly, different customers' needs force them to find new products. For instance, they changed local bakeries behavior. Bakeries were serving their *"Turkish Pizza"* within a paper bag and firm introduced a well-designed cheap carton box. Hence, bakeries can deliver their products warm and far areas. In addition, they have collaborated with local government support the organization to invest in a new machine. By this way, they increased their product range and were able to offer new products. Internally, employee participation is not encouraged at firm. Manager does not share his authority with any employees and monitors all activities. Thus, he cannot spend more time to scan and search new opportunities.

Source of innovation capability illustrates some similarities and differences at firms as table-3 illustrates.

Table – 3 Comparison three cases

	Source of Innovation	Firm A	Firm B	Firm C
Internal	Employee Participation	Employees generate new ideas and participate strategic activities.	Employees rarely share their ideas.	Employees do not share any ideas.
	Leadership	Manager works as a new furniture models designer. He scans and searches new opportunities.	Manager spends most of his time to introduce new products and senses for new opportunities.	Manager spends most of his time to control day-to-day activities and he cannot find time for searching new opportunities.
External	Customer Engagement	Firm has good relations with customers. They have loyal customers and they bring new ideas into business.	Customers are seen valuable source of new ideas and they design their new products based on customers` requests.	They provide new solutions for different customer requests.
	Networking and Collaboration	They use advantage of producing in a furniture industry area and collaborate with other manufacturers to increase their production capability	They collaborate with GSOs to get fund for new equipment and find skilled workforce.	They collaborate with GSOs to invest for new equipment.

FINDINGS

In this research, it is aimed to understand development of innovation capability at micro enterprises. Different sources are identified for development of innovation capability but micro enterprises cannot develop certain processes such as hiring well-educated employees, R&D or acquisition (Prajogo et al. 2013; Tie-jun and Jin, 2006). Certain factors enable micro enterprises to develop innovation capabilities as idea generation and leadership (internal), customer engagement, and networking and collaboration (external). Idea generation activities are seen as an important factor for innovation capability. In micro enterprises, owner/managers should encourage their employees to share and generate ideas. In two cases, owners encourage their employees to share ideas and operationally they are more innovative than C. Owner of firm C does not like to share his authority and does not listen his employees. Command and control culture are dominant and prevent employees to participate any innovation activities. On the other hand, owners of firm A and B share authority and encourage their employees for receiving new ideas from them. Moreover, owners of A and B have more time for searching and scanning activities while owner of firm C spends all his time to monitor and control his employees. As a result, relationship between leadership and employee participation is positive and encouraging employees, rewarding their contributions and sharing authority creates an innovative working environment in micro enterprises.

On the other hand, external factors have a huge impact on innovation capabilities of micro enterprises. In literature, different factors are represented as having influence on innovation capability but two factors have positive impact on innovation capability. Customers are forcing all firms to improve and innovate their products. In some cases, customers bring ideas and firm convert these ideas into new products. Thus, micro enterprises should develop customer engagement to understand customers` need and fulfill those needs with innovative solutions (Adler and Shenhar, 1990). Networking activities enable firms to access new information (Tie-jun and Jin, 2006). Micro enterprises are not able to employ people to scan and search new information but they are able to access new information via their network. Thus, networking activities has substantial role in micro enterprises for development of innovation capabilities. Collaboration with different organizations and/or businesses also contributes their innovation capability positively (Saunila 2014; Tie-jun and Jin, 2006). Especially manufacturing equipment, which they use, has limited capabilities and financial difficulties prevent them to invest for new equipment. Thus, collaborating with other businesses to share equipment together increases their production capabilities and enables them to produce new and/or improved products. As a result, micro enterprises should focus on developing networking and collaboration, and customer engagement activities to develop innovation capability.

CONCLUSION

It can be concluded that financial and educational constraints prevent micro enterprises to develop similar innovation processes as large, small and medium size enterprises. Thus, they should follow applicable methods such as encouraging employee participation, developing leadership skills that aims to motivate employees and himself/herself as leader for finding new ideas and opportunities, spending more time for networking and collaboration activities to access new information and improve production capacity. These factors enable firms to develop and improve innovation capability. There are some limitations of this research. It is difficult to make a general statement based on three case studies. Further research is required with bigger sample sizes to improve generalizability.

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