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Employee Perception on Factors of Innovation Capability That Influence SME
Performance: A Study of SME in Melaka

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**EMPLOYEE PERCEPTION ON FACTORS OF INNOVATION CAPABILITY
THAT INFLUENCE SME PERFORMANCE: A STUDY OF SME IN MELAKA**

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**Report Submitted in Fulfillment of the Requirements for Bachelor Degree of
Technopreneurship with Honors**

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DECLARATION OF ORIGINAL WORK

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“I hereby declare that the work of this exercise is mine except for the quotations and summaries that have been duly acknowledge.”

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DEDICATION

This research paper is dedicated to my beloved families who have been my constant source of inspiration. They have given me the drive and discipline to tackle any task with enthusiasm and determination. Without their love and support this project would not have been made possible.

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ABSTRACT

This research is a study on innovation capability that influences the SME performance. The scope of this research is at the SME located in Melaka. Fundamentally, the researcher defines on the existing of innovation on SME in Melaka. Researcher is investigating factors of innovation capability that influence SME performance which are leadership factor, culture factor and employee development factor. Researcher also identifies the relationship between the relationship between factors of innovation capabilities and performance improvement in SME. The performance that will be investigated is SME performance. Next, the method use in this research is quantitative method. Researcher make survey by distributes 100 questionnaire to employee of SME in Melaka. The respondent for this distribution is involving a number of respondent that being calculated using non sampling method. Several analyses that involved are descriptive analysis, reliability analysis, Pearson's correlation analysis and multiple regression analysis. The result for objective 1, have been shown that there are 73% of SME Company is dedicated to innovation capability and most of them are in technological innovation. Second objective result is in multiple regression analysis of each question proves that leadership, culture and employee development factors are the factor of innovation capability. Pearson's correlation is use to answer objective 3, the result shows that there were positive relationship between independent variables and dependent variables which is growth performance. The entire hypothesis is accepted. The recommendation that researcher can recommend to future researcher is future researcher need to provide extra information about innovation capability in SME. Next, researcher recommend to future researcher to broad the location and area of data collection. Last, researcher recommend to future researcher to make a research on all type of SME industry.

ABSTRAK

Kajian ini merupakan kajian keupayaan inovasi yang mempengaruhi prestasi PKS. Skop kajian ini adalah di SME yang terletak di Melaka. Secara asasnya, penyelidik menentukan tentang inovasi yang ada pada SME di Melaka. Penyelidik sedang menyiasat faktor keupayaan inovasi yang mempengaruhi prestasi PKS yang merupakan faktor kepimpinan, faktor budaya dan faktor pembangunan pekerja. Penyelidik juga mengenal pasti hubungan antara faktor keupayaan inovasi dan peningkatan prestasi dalam PKS. Prestasi yang akan disiasat adalah prestasi PKS. Seterusnya, kaedah yang digunakan dalam kajian ini adalah kaedah kuantitatif. Penyelidik membuat tinjauan dengan menyebarkan 100 soal selidik kepada pekerja SME di Melaka. Responden untuk taburan ini melibatkan sejumlah responden yang dikira menggunakan kaedah bukan sampel. Beberapa analisis yang terlibat adalah analisis deskriptif, analisis kebolehpercayaan, analisis korelasi Pearson dan analisis regresi berganda. Hasilnya untuk objektif 1, telah ditunjukkan bahawa terdapat 73% Perusahaan SME yang didedikasikan untuk keupayaan inovasi dan kebanyakannya berada dalam inovasi teknologi. Hasil objektif kedua adalah dalam analisis regresi berganda setiap soalan membuktikan bahawa kepemimpinan, kebudayaan dan faktor pembangunan pekerja adalah faktor keupayaan inovasi. Hubungan korelasi Pearson digunakan untuk menjawab objektif 3, hasilnya menunjukkan terdapat hubungan positif antara pembolehubah bebas dan pemboleh ubah bergantung yang merupakan prestasi pertumbuhan. Seluruh hipotesis diterima. Cadangan bahawa penyelidik boleh mengesyorkan kepada penyelidik masa depan adalah penyelidik masa depan perlu memberikan maklumat tambahan mengenai keupayaan inovasi dalam PKS. Seterusnya, penyelidik mencadangkan kepada penyelidik masa depan untuk meluaskan lokasi dan kawasan pengumpulan data. Akhir sekali, penyelidik mengesyorkan kepada penyelidik masa depan untuk membuat penyelidikan ke atas semua jenis industri PKS.

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CHAPTER 1

INTRODUCTION

1.1 BACKGROUND OF STUDY

Innovations play an essential role in today's society's everyday activities, covering all areas of our lives. Because they can create a new room for possible development and future growth, inventions have become an important aspect of every business activity (Ehrenberger, Koudelková and Strielkowski, 2015). Innovation has become a key issue for businesses, organisations and governments at different levels, and its significance has driven researchers to recognize their different driving forces. The academic literature provides a wealth of evidence suggesting a positive relationship between innovation and firm success in the manufacturing sector (Psomas, 2015). Innovation has become a key requirement, regardless of the size and sector of the product. Small and medium-sized enterprises (SMEs) faced the need to build profitability through effective and efficient innovation with generally limited resources and skills (Kim, Park and Paik, 2017).

Thanks to their creative capacities, SMEs typically make a valuable economic and social contribution. SMEs in sectors such as IT and biotechnology (BT) depended on innovation to improve their efficiency and competitiveness. Setting up and improving innovation potential has thus emerged as a major challenge for SMEs (Small and Medium Business Administration, 2015). Under increasingly volatile market conditions, the company's ability to innovate is the most crucial factor for competitive advantage. Innovation ability drives companies to continually create innovations to adapt to the

changing market environment, embedding them with all the techniques, processes and frameworks that enable an organization's innovation (Gloet and Samson, 2016). SMEs may contribute to innovation in technology and economic growth. SMEs play a key role in promoting and sustaining regional economic growth and development focused on innovation (Choi and Lim, 2017).

SMEs typically have a high innovation potential, which can contribute to innovation styles other than commercial products. Innovation capacity is hard to specify directly, similar to intangibles in general, but it can be specified by defining closely related aspects. These innovation capacity aspects are also inputs from innovation activity (Saunila and Ukko, 2014). Nonetheless, innovation capacity is one of the most critical factors that allow SMEs to achieve a high level of competitiveness on both domestic and international markets (Minna Saunila, 2016). The importance of SMEs to the Malaysian economy's growth and development cannot be ignored and has become an important aspect of Malaysia's economic growth. The importance of SMEs in economic development, poverty reduction, job growth, output, technological innovation, and social and standard lifting is proven and recognized globally in both emerging and developed economies (Eniola and Entebang, 2015).

SMEs play an important role in the economic development of Malaysia. SMEs play an important role in contributing to the prosperity of large and multinational corporations (MNCs) through their entrepreneurial creativity and innovation (Kayadibi, Polat and Fidan, 2013) in addition to creating employment. SMEs as companies in a dynamic environment are a must, then creativity. High-tech industry, pace of research and development, concentration of markets and export volume are increasing further innovation activities in the high-tech industry. Innovation practices, low-tech sectors, have a strong and significant impact on productivity. Innovation is a key aspect that leads to competitive advantage (Ismanu and Kusmintarti, 2017).

1.2 SME IN MALAYSIA

Considering that many developments in the economy have taken place since 2005, such as price inflation, structural changes and shifts in market patterns, a review of the concept was conducted in 2013 and a new definition of SMEs was endorsed at the 14th NSDC meeting in July 2013. The concept encompasses all sectors (SME Corporation Malaysia, 2019), namely retail, manufacturing, agriculture, construction and mining and quarrying. Small and medium-sized enterprises (SMEs) may have distinct distinguishing characteristics for larger enterprises. Through specialized management with little devolution of authority, SMEs vary from larger companies. We have resource constraints in terms of management, manpower and finance, and are usually dependent on a small number of customers and operate in restricted markets. On the other hand, SMEs may also have simple, scalable systems, high potential for creativity, reactive mindset, and informal, competitive approaches (Saunila, 2016).

Malaysian SMEs are concentrated in the sectors of textiles and clothes, food and beverages, metals and services, and wood products. Many manufacturing firms are based in the central parts of Malaysia and around the major industrial regions of the country. Malaysian SMEs are engaged in a variety of industries. It is important to identify or categorize the SMEs in Malaysia in order to determine the importance of SMEs in the country, particularly in terms of their economic contribution. SME Corporation Malaysia (SME Corp. Malaysia) is the central coordinating agency (CCA) under the Ministry of Entrepreneur Development Malaysia (MED) overseeing the implementation of small and medium-sized enterprise (SME) development programs across all relevant ministries and agencies. It serves as the central reference point for analysis and dissemination of data on SMEs and entrepreneurs, as well as offering business consulting services to SMEs and entrepreneurs across the world. Malaysia is also the Secretariat of the National Council for SME Development (NSDC), headed by Malaysia's Prime Minister (SME Corporation Malaysia, 2019).

1.3 PROBLEM STATEMENT

Several SMEs face enormous obstacles in their efforts to pursue technological innovation, including financial constraints, knowledge shortages, poor inter-company relationships, and regulatory burdens (Choi and Lim, 2017). Most SMEs have plunged into an unparalleled situation since the financial crisis began in 2007 (Chen, Zhu and Zhang, 2017). SMEs have found it difficult to gain a foothold in the market in the increasingly fierce competition by relying on the manufacture of products designed by other firms. SMEs are facing increasing global competition in today's market, rapid changes in customer demand, and ever-changing technologies. Innovative ideas along with efficiency and effectiveness of implementing these ideas are required for a successful organization. A good creative outcome will benefit from these innovative ideas and successful implementation (Hasliza, Noor Hazlina, T. Ramayah, Haniruzila Hanifah, Seyedeh Khadijeh Taghizadeh and Marini Nurbanum, 2015).

On the one side, it requires resources that can be challenging for a small and medium-sized company. It is well known that because of credit constraints, SMEs face tight financial resource restrictions (Nixson and Cook, 2015). Innovation has therefore become essential to the survival and growth of SMEs (Chen, Zhu and Zhang, 2017). SMEs face major challenges as several studies identify the structural weaknesses of small and medium-sized enterprises that undermine their potential for innovation and profitability, thereby undermining their survival (Vanegas, 2018). Increasing market transparency, increasing technological change rate, loose management of information assets and human capital, poor skills of business owners and employees, drawbacks of localization and infrastructure, which make it difficult for SMEs to succeed in highly competitive markets (Morales, Loaiza and Vanegas, 2019).

1.4 RESEARCH QUESTION

Referring to problem statement, researcher creates three research questions. The research question of this research are :

1. What are the existing innovation capabilities in SMEs?
2. What are the factors that influence of innovation capabilities in SMEs?
3. How the factors of innovation capabilities can relate with the performance improvement in SMEs?

1.5 RESEARCH OBJECTIVES

The objectives of this research are :

1. To investigate the existing innovation capabilities in SMEs.
2. To study the factors that influence innovation capabilities in SMEs.
3. To examine the relationship between factors of innovation capabilities and performance improvement in SMEs.

1.6 SCOPE AND LIMITATION OF STUDY

The researcher focuses only on the factors of potential for innovation in Melaka SMEs. Researchers are therefore not discussing and researching other problems such as obstacles and barriers to innovation potential in SMEs. This is because there is insufficient time and knowledge to complete this report. In addition, the factors that have been mentioned are the latest factors that other researchers around the world have been investigating.

1.7 SIGNIFICANT OF STUDY

To boost the SME's efficiency, innovation is really necessary. As Malaysian SME's success is a major change in the country of the economy. Capacity for creativity is the factor that affects results. Malaysian small and medium-sized enterprises are still in the rising stage, with factors influencing innovation potential and the rapid growth of innovation. Therefore, the researcher also attaches importance to the relationship between innovation capacity factors and Melaka's performance enhancement of SMEs.

1.8 SUMMARY

As a conclusion, researchers are developing the background analysis of innovation and innovation capability in SMEs around the world in this chapter. Researcher also addresses the condition of SMEs in Malaysia with respect to the website of the SME Corporation. First, this report includes problem statements that SMEs are facing challenges in their attempts to implement technological innovation. Yet creativity has also become essential to the survival yet growth of SMEs. Questions for study are divided into three. The study objective is benefit from the problem of analysis. Research reach and limitation is addressing the limit of this study that is based only on the Melaka SME. And lastly, significant of study discuss on the important of this research that influence Malaysia's economy.

CHAPTER 2

LITERATURE REVIEW

2.1 INTRODUCTION

Innovation can be defined, according to (Schumpeter, 1997), as applying new ideas to the product, process or any other aspects of the company's activities. Innovation is a specific and multi-dimensional term that applies to all scientific, technical, organizational, financial and commercial activities leading to, or intended to lead to, the introduction of new or improved products or services (OECD, 1997). Innovation has become a key issue for businesses, organizations and governments at different levels, and its significance has driven researchers to recognize their different driving forces (Becheikh, 2006). Innovation is characterized as a mandatory innovation component that includes the new or improved product or method, a new marketing strategy, and new business practices organizational behavior (Hasan Askoy, 2017). Innovation means making something modern and industrial developments include technical development, design, distribution, and management (Wang, 2019). Innovation is as a process, product, and organization of new ideas, according to (Hult, Hurley, and Knight, 2004).

(Schumpeter, 1997) stated that innovation types such as introducing a new or qualitative change in an existing product, processing innovation new to an industry, opening up a new market, developing new sources of supply for raw materials or other inputs, and changing the organization of industry. According to (Jorge Lopez, 2015), technology and the market provide four types of innovation that are incremental innovation, disruptive innovation, innovation in architecture, and radical innovation. The most common form of innovation is incremental innovation. This uses existing technologies and improves demand in the existing market for consumer services and improvements in design. Disruptive innovation, also known as disruptive innovation, is

the introduction of new technology or processes to the current market of your business. Architectural creativity simply takes and implements the principles, expertise and overall knowledge in a different marketplace. This innovation is amazing as long as the new market is receptive to growing new customers. Radical innovation is an invention that is considered. New industries are born and revolutionary technology is created.

2.2 EMPLOYEE PERCEPTION

Employee perception is created in the workplace through organizational positions, leadership styles, and communication styles, and it is therefore very important that the company should shape the correct perception in the minds of its employees. Communication is the key to employee growth. Communication is a key aspect. Anything we do will be pointless if it is not well conveyed to the target audience. With regard to the perception of employees, it is crucial for companies to ensure aggressive communication to their employees about their goals, mission and vision. Finally, it is necessary to engage employees. It is important to have not only the right HR practices in the company but the right employee expectations of those practices in order to achieve the desired organizational objectives. Workers would be more involved if they noticed that the HR policies were more driven by the organization's concern for high-quality service and employee well-being than by a desire to cut costs and manipulate workers.

2.3 INNOVATION CAPABILITY

Innovation capacity, according to (Lawson and Samson, 2001), is a theoretical framework to describe the actions that can be taken to improve the success of innovation activities. According to (Forsman, 2011), therefore, innovation capacity is defined as the continuous development of skills and resources enabling a company to explore and exploit new opportunities to introduce new products and meet market needs. According to (Olsson, 2010) concluded that innovation capability is the most critical for businesses as it enables them to respond effectively and efficiently to both market needs and business environment fluctuations. Since innovation capacity is a special asset that enables any company to generate new ideas, develop new products, improve operational processes, and take risks, it is essential for companies to pursue successful innovation (Guann and Ma, 2003).

In this analysis, innovation capacity is described as an internal capacity to describe the determinants that affect the ability of an organization to continually achieve innovations and add value to the organization and its stakeholders. Innovation potential may not be a unitary set of attributes, and the attributes are interrelated but not independent of each other (Francis and Bessant, 2005). Different types of innovation may require distinctive approaches (Francis and Bessant, 2005), or different types of organizations may use different determinants to develop capacity for innovation (Saunila and Ukko, 2014). Therefore, the potential for creativity varies from company to company and is dictated by several factors. Innovation capability itself is not a concept that can be independently defined. The capacity consists of improving the company's procedures and processes. These processes are a key mechanism to stimulate measure and strengthen innovation (Lawson and Samson, 2001).

2.4 INNOVATION CAPABILITY AND SME PERFORMANCE

The ability to innovate is a core determinant of firm success. It is difficult to expect continuous and company-wide innovation and successful firm results without building innovation capacity. Since SMEs are especially restricted in their internal resources and external responsiveness, they need to strengthen their capacity for innovation in order to make productive use of innovation assets and broaden international cooperation (Kim, Park and Paik, 2017). Innovation skills have a positive effect on the efficiency of SMEs, according to (Rosenbusch, Brinckmann and Bausch, 2009). The implementation of an innovation orientation has more positive effects on firm results than the result of the innovation process. The effects of the innovation cycle lead to increased production of SMEs. Innovation's overall impact on a SME's output is an aggregate effect arising from both positive and negative mediating effects that are further moderated by contextual factors. The innovation-to-SME performance relationship is positive (Rosenbusch, Brinckmann and Bausch, 2009). There are two performances that will be addressed in this study, which are production.

Researchers usually assess the ability of a company based on its growth (Dobbs and Hamilton, 2006). Empirical research indicates that if there is a constant supply of finance, there is a positive relationship between innovation and company growth (Hyytinen and Toivanen, 2003). The overall firm efficiency would be enhanced in the presence of innovation (Rosli and Sidek, 2013). This shows that innovation is essential to the organization's growth in terms of revenue, market penetration, competitiveness and organizational sustainability, especially for small and medium-sized enterprises. (Coad and Rao, 2008) noted that for selected fast-growing companies, creativity is key. If any innovation conducted is successful, the share of innovative new products is likely to increase in the company's total revenue, and if this happens, businesses will be able to achieve growth in their sales turnover, investment and jobs, all resulting in company size growth.

2.5 INNOVATION CAPABILITIES FACTORS

Innovation capacity is defined as the driving force behind innovation, such as factors affecting the ability of an organization to handle innovation. The factors influencing performance of SMEs are leadership, culture, and employee development, according to the previous literature.

2.5.1 Leadership

Leadership culture refers to the organization's overall atmosphere that promotes and motivates creativity and innovation-friendly leadership. It is important for an organization to be able to lead, direct, and support the creation and maintenance of innovation behaviors (Bessant, 2003). In order to make innovation a key capability of small and medium-sized enterprises, it is important to have leadership in top management and employee leadership skills that promote innovation, and an external network that compensates for the general lack of SMEs' capital and efficiency (Kim, Park and Paik, 2017).

2.5.1.1 Top Management leadership

Previous studies have shown that top management is closely linked to firm innovation (Makri and Scandura, 2010). To order to promote innovation (Elenkov and Manev, 2005), top management has a strong influence on innovation practices, organizing the structure, processes and culture of the organization. Innovative top management has supported innovation in SMEs by identifying new areas of technology applications, developing human capital to improve internal knowledge, and networking with external organizations to access resources that are internally lacking (Vaccaro, 2012). (McAdam, 2010) explored the significance of innovation leadership in the development and implementation of SME innovation. (McGuirk, 2015) empirically demonstrated that, due to individual readiness for change, creative managers can promote innovation in small businesses. Nevertheless, the relationship between top management leadership and innovation potential was discussed empirically only by a few studies (Makri and Scandura, 2010).