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Building small firm performance through intellectual capital development: Exploring innovation as the “black box”[☆]

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ABSTRACT

Innovation seems to be a fundamental requirement for the growth and sustainability of small businesses. While previous research revealed a strong correlation between intellectual capital and performance, the role of intellectual capital in facilitating the innovativeness and performance of a firm has not been thoroughly examined in the small and medium-sized enterprise (SME) context. This study examines the role of innovativeness in the intellectual capital and organizational performance relationship using a sample of small firms. The results of a survey conducted on 460 small business owners indicate a positive relationship between two components of intellectual capital, human capital and organizational capital, and organizational performance. Further analysis finds that innovativeness partially mediates the relationship between intellectual capital and organizational performance. Our findings indicate that efficiently and effectively organized firms can leverage well skilled and innovative employees to achieve the best performance through innovation.

1. Introduction

Small and medium-sized enterprises (SMEs) must often be creative and diligent in establishing, solidifying, and defending strategies for sustained competitive advantage, given the difficulties in realizing gains from economies of scale (Patel & Jayaram, 2014; Wales, Patel, Parida, & Kreiser, 2013). Researchers argue that the development and deployment of knowledge-based resources are critically important tools for firms to garner a sustained competitive advantage and greater profitability (Cohen & Levinthal, 1990; Grant, 1996a, 1996b; Kogut & Zander, 1992). In particular, these intangible resources have been shown to be more important than tangible assets in the early stages of new venture development (Lichtenstein & Brush, 2001).

Entrepreneurs and small business owners have been consistently coached to focus on the novelty of their offerings compared to their often larger competitors, as well as to utilize their firm-specific knowledge to establish processes and routines that make them nimble (Rosenbusch, Brinckmann, & Bausch, 2011; Zulu-Chisanga, Boso, Adeola, & Oghazi, 2016). Response speed and ability to adapt to market demands allow SMEs to leverage the advantages of their “smallness” through innovation (Leal-Rodríguez & Alborn-Morant, 2016;

Rosenbusch et al., 2011). Therefore, innovation is an important topic of investigation in the research on SME performance. Most scholars consider innovation a key source of sustainable competitive advantage for SMEs (Andries & Czarnitzki, 2014; Rosenbusch et al., 2011). Based on the tenets of the Knowledge-based View (Grant, 1996a, 1996b; Kogut & Zander, 1992), which extends from the Resource-based View (Barney, 1991), the ability to successfully leverage innovation as a key firm strategy depends on the knowledge, skills, and other capabilities within the firm (Andries & Czarnitzki, 2014; Dibrell, Davis, & Craig, 2008; Subramaniam & Youndt, 2005). Thornhill (2006) argues that “...what an organization knows determines what it can do” (p. 691).

Small organizations often invest heavily in intellectual capital through their employees, communications, and processes and leverage such investments to foster innovation within the company (Maes & Sels, 2014; Thornhill, 2006). Therefore, the relationship between the development, accumulation, and distribution of knowledge (facilitated by intellectual capital development) and performance is likely to be indirect. Organizations work to build intellectual capital, which likely serves as an input to enhancing the firm’s innovation strategy (Maes & Sels, 2014; Subramaniam & Youndt, 2005; Thornhill, 2006), providing sustained performance advantages. The effects and relationships among

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intellectual capital, innovation, and business performance in the SME context are, however, ambiguous and generally under-investigated (Gronum, Verreyne, & Kastelle, 2012).

Although the relationship between intellectual capital and innovation has been addressed in several ways in the SME context (Thornhill, 2006), to the best of our knowledge, an analysis of the mediating impact of innovation on the relationship between intellectual capital development and SME performance has not been conducted yet. Using the Resource-based View (RBV) approach, we aim at providing a preliminary examination of the mediating role of innovation as a strategic choice for SMEs (Thornhill, 2006), which translates intellectual capital stocks into enhanced firm performance. To this end, we use well-established measures for intellectual capital (Subramaniam & Youndt, 2005), innovation (Subramaniam & Youndt, 2005), and performance (Droge, Jayaram, & Vickery, 2004; Runyan, Droge, & Swinney, 2008) to analyze their relationships in a sample of 460 SMEs in the United States.

The remainder of this paper is organized as follows. In the second section, we examine intellectual capital and innovation in light of the RBV to develop our research hypotheses. In the third section, we describe our sample, measures, and methods, followed by a section that discusses the results of the examination of our hypotheses. In the last section, we discuss the academic and practical implications of our results and address both the limitations of our investigation and opportunities for future research.

2. Theory development and hypotheses

Stemming from the resource-based view (Barney, 1991), the knowledge-based view of the firm (Kogut & Zander, 1992) suggests that integration of knowledge is the primary mean for a business to develop a sustainable competitive advantage (Grant, 1996a). Knowledge has been argued as perhaps the most important resource for companies (Grant, 1996a; Lichtenstein & Brush, 2001) from a strategic perspective, as knowledge manifests itself through human capital development, interaction among people, and systematization of the resulting improved knowledge (Kogut & Zander, 1992; Subramaniam & Youndt, 2005). The knowledge-based view proposes that knowledge, as “know-how,” is both developed and exploited (Grant, 1996a, 1996b; Kogut & Zander, 1992). The development and exploitation of this tacit knowledge generate combinations of capabilities that are difficult for other firms to observe, isolate, and imitate (Barney, 1995; Teece, Pisano, & Shuen, 1997) as they are socially constructed and embedded within the organization (Kogut & Zander, 1992).

Knowledge is created and applied by the firm in the attempt to yield superior performance (Cohen & Levinthal, 1990; Grant, 1996a, 1996b). Subramaniam and Youndt (2005) suggest that knowledge is accumulated by the firm through individuals (human capital), relationships and networks (social capital), and the systematization of knowledge through processes and systems (organizational capital). Together, these forms of capital have been termed intellectual capital (Reed, Lubatkin, & Srinivasan, 2006; Youndt, Subramaniam, & Snell, 2004). In line with the knowledge-based view, Guthrie, Petty, and Ricceri (2006) contend that intellectual capital is an integral part of the firm's value, although assessing its actual value as a vital intangible asset may be difficult.

2.1. Human capital

The knowledge-based view suggests that knowledge emanates from individuals (Grant, 1996a, 1996b), and, therefore, human capital generally represents the resources created from the stocks and flows of knowledge and shared among individual owners, managers, and employees within a firm (Becker, 1962; Pennings, Lee, & Van Witteloostuijn, 1998). However, human capital is neither acquired nor “owned” the way that some other types of capital (i.e., physical, technological, financial capital) are stored by organizations; thus, human capital can leave the firm with the departure of an employee (Brymer,

Molloy, & Gilbert, 2014; Campbell, Coff, & Kryscynski, 2012). Despite this lack of firm ownership, human capital is considered one of the most important assets for an organization, and differences in human capital levels among organizations have been associated with the emergence of a competitive advantage (Ployhart & Moliterno, 2011; Reed et al., 2006). Subramaniam and Youndt (2005) contend that bright employees with tacit knowledge bring new ideas and knowledge to the organization, yielding an advantage through their superior capabilities in opportunity identification.

Scholars have widely acknowledged that human capital is a critical component of firm performance (Bendickson, Muldoon, Liguori, & Midgett, 2017; Colombo & Grilli, 2005; Reed et al., 2006), particularly when human capital investments focus on knowledge and skills rather than education levels (Unger, Rauch, Frese, & Rosenbusch, 2011). Prior empirical research suggests that entrepreneurs whose human capital comprises unique, or tacit, knowledge achieve greater entrepreneurial success and revenue productivity (Staniewski, 2016; Unger et al., 2011). Both Oh, Kim, and Van Iddekinge (2015) and Reed et al. (2006) found that human capital levels positively impact firm performance in both small and large organizations. Samagaio and Rodrigues (2016) found similar results in a study on young audit firms. The meta-analysis of human capital and performance conducted by Unger et al. (2011) further underscores the critical role that human capital as “know-how” plays in entrepreneurial success. Given both the tenets of the knowledge-based view and prior empirical research tying human capital to firm performance, we introduce the following hypothesis.

Hypothesis 1. Human capital will be positively associated with small firm performance.

2.2. Social capital

The communication and information sharing that occurs via social networks, both internally and externally, are often considered critical for integrating and synthesizing the knowledge generated by employees (Subramaniam & Youndt, 2005). Social capital is defined as “the sum of the actual and potential resources embedded within, available through and derived from the network of relationships possessed by an individual or social unit” (Nahapiet & Ghoshal, 1998, p. 243). Researchers suggest that significant breakthroughs and competitive advantage are outcomes of the social capital accrued in exchanges of tacit and explicit knowledge via networks within organizations (Smith & Coakes, 2012). Social capital development requires close attention to the fostering of norms and values within the firm that enable interaction, facilitate the development of relationships, and spur collaboration among employees (Subramaniam & Youndt, 2005). Social capital, as an intangible resource, is difficult for competitors to imitate and creates value for the firm through the communication and assimilation of individual-level knowledge, helping firms achieve and sustain competitive advantages (Barney, 2001; Martín-de-Castro, Delgado-Verde, López-Sáez, & Navas-López, 2011).

Prior research suggests that social capital is, in fact, an essential determinant of SME performance. Stable networks and work relationships have been shown to lead to higher levels of trust and goal congruence among organization members (De Clercq, Dimov, & Thongpapanl, 2013) and exhibit a direct, positive relationship with both firm performance and sales growth (Fonti & Maoret, 2016; Gronum et al., 2012). Given both the value of social capital as an intangible resource and prior research related to social capital, we introduce the following hypothesis.

Hypothesis 2. Social capital will be positively associated with small firm performance.

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