Entrepreneurial Leadership and Organizational Performance of SMEs: The Mediating Role of Innovation Capacity

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Abstract

This conceptual paper examines how entrepreneurial leadership may influence the organizational performance of small and medium-sized enterprises (SMEs) through the mediating role of innovation capacity. Building on a three-construct research framework, it integrates the resource-based view, dynamic-capability theory, and strategic entrepreneurship to explain why opportunity-oriented leadership may produce value only when firms develop routines for acquiring, combining, testing, and implementing knowledge. Entrepreneurial leadership is conceptualized as an influence process directed toward recognizing and exploiting opportunities; innovation capacity as a repeatable organizational ability rather than an isolated innovation outcome; and performance as a multidimensional combination of financial, market, and operational results. Four propositions address the direct leadership–performance relationship, leadership–innovation capacity relationship, innovation capacity–performance relationship, and the indirect pathway connecting the constructs. The paper also identifies environmental dynamism, resource constraints, innovation type, and firm maturity as relevant boundary conditions. A proposed longitudinal, multi-source research design outlines the measurement and testing of these propositions in SME settings such as Pakistan. The contribution is a clarified causal mechanism and a practicable empirical research agenda, rather than a claim of new statistical findings. All cited scholarship was published no later than 2022.

1. Introduction

Small and medium-sized enterprises (SMEs) perform an important economic function by translating localized knowledge, specialized skills, and entrepreneurial initiative into goods, services, and employment. Their organizational structures often permit rapid decisions and close interactions between owners, employees, suppliers, and customers. These characteristics may facilitate responsiveness, but small scale does not automatically generate competitive advantage. SMEs also face constraints in finance, specialized personnel, technological infrastructure, and access to external knowledge. The strategic problem is therefore not simply whether a firm possesses resources, but how its leaders mobilize those resources to identify opportunities, develop new solutions, and deliver results. Resource-based and entrepreneurial perspectives suggest that leadership and organizational capabilities should be examined together rather than treated as unrelated determinants of performance (Barney, 1991; Ireland et al., 2003; Sirmon et al., 2007).

Entrepreneurial leadership has emerged as a useful concept for explaining how leaders orient collective effort toward opportunity recognition and exploitation. It differs from a generic emphasis on employee supervision: entrepreneurial leaders communicate an opportunity-focused vision, encourage initiative, build confidence in experimentation, and organize people to act under uncertainty. Gupta et al. (2004) developed

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the construct across cultural settings, while Renko et al. (2015) described its focus on influencing others to achieve goals associated with entrepreneurial opportunities. Yet a leader's capacity to stimulate opportunity seeking need not translate directly into improved financial or operational performance. Between leadership intentions and business outcomes lie routines through which a firm acquires knowledge, experiments, implements ideas, and learns from their consequences.

Innovation capacity is proposed as that intervening organizational capability. In this paper, it means the repeatable ability of an SME to generate or absorb promising ideas, mobilize relevant resources, and turn knowledge into useful changes in products, services, processes, or business practices. Capacity is distinct from a specific innovation outcome: an enterprise may possess promising capabilities while delaying product launches, and it may report a one-off innovation without possessing durable routines. This distinction matters in resource-constrained settings, where the ability to innovate repeatedly may be more consequential than a single invention. Studies linking learning, innovativeness, and organizational outcomes provide a basis for examining innovation as a mechanism rather than a decorative attribute of entrepreneurship (Calantone et al., 2002; Crossan & Apaydin, 2010).

The starting point of this conceptual article is the supplied research framework, which places entrepreneurial leadership as the independent variable, organizational performance as the dependent variable, and innovation capacity as a mediator. The underlying objectives are to explain the leadership–performance relationship, the innovation-capacity–performance relationship, and the indirect role of innovation capacity. The source framework's diagram refers once to “innovation management,” but its title, objectives, research questions, and hypotheses consistently identify “innovation capacity”; that construct is used throughout this paper. The model is developed conceptually, without treating the framework document's questionnaire discussion as fresh empirical evidence.

The mechanism is especially relevant to SMEs because owner-managers may influence both strategy and daily operating practices, making leadership highly visible while also making results dependent on employees' opportunities to learn and implement changes. However, the claim that innovation invariably improves performance must be qualified. Innovation consumes resources, creates uncertainty, and may yield benefits only after commercialization. A meta-analysis of SMEs by Rosenbusch et al. (2011) found a context-dependent association between innovation and performance. Accordingly, the present paper proposes a generally positive relationship but identifies important conditions under which this expectation may weaken or reverse.

1.1 Research problem and contribution

The central conceptual problem is an explanatory gap between leadership behavior and organizational outcomes. Stating that entrepreneurial leaders improve SME performance does not explain how inspiration, opportunity recognition, or calculated risk taking becomes productivity, customer value, or growth. Existing scholarship addresses important pieces of the problem, including entrepreneurial leadership and firm growth (Koryak et al., 2015), entrepreneurial leadership and employees' innovative behavior (Bagheri, 2017), and innovation-related mediation in new ventures (Huang et al., 2014). Moreover, Sawaean and Ali (2020) reported evidence of innovation capacity mediating relationships involving entrepreneurial leadership and performance among SMEs in Kuwait. Thus, mediation is not presented here as an unexamined or original empirical discovery.

This paper contributes by specifying the causal logic in a parsimonious three-construct model, distinguishing organizational innovation capacity from innovation output and managerial innovation

practices, identifying boundary conditions, and developing a feasible research design for future testing in settings such as Pakistan. Its intended value is conceptual clarity and transferability across industries, not a claim that the relationship has never been studied. It also makes explicit the possibility of a residual direct leadership–performance pathway: leaders can improve resource allocation, customer responsiveness, or employee coordination even before an innovation process produces results.

1.2 Objectives and guiding questions

Three questions organize the argument. First, through which managerial mechanisms might entrepreneurial leadership enhance SME organizational performance? Second, why should a stronger capacity for innovation improve financial and nonfinancial outcomes, and under what conditions might it fail to do so? Third, how and to what extent can innovation capacity transmit part of the effect of entrepreneurial leadership to performance? These questions lead to four propositions concerning the direct leadership–performance path, the leadership–capacity path, the capacity–performance path, and their mediated relationship.

2. Conceptual and Empirical Literature

2.1 Entrepreneurial leadership as an opportunity-oriented influence process

Entrepreneurial leadership brings together the opportunity orientation associated with entrepreneurship and the collective influence processes associated with leadership. Gupta et al. (2004) placed entrepreneurial leadership within a cross-cultural framework, emphasizing the enactment of opportunity-oriented roles under uncertainty. Renko et al. (2015) sharpened its distinction from generalized leadership by centering group efforts on recognizing and exploiting entrepreneurial opportunities. These formulations indicate that entrepreneurial leadership is not synonymous with founder status, charismatic presentation, or a general willingness to take risks. It is a behavioral process in which leaders direct attention, provide meaning, mobilize support, and legitimate initiatives aimed at creating future value.

A useful operational interpretation includes opportunity scanning, an ambitious but credible vision, resourceful action, empowerment, and tolerance for informed experimentation. Entrepreneurial leaders may invite employees to challenge established routines, organize rapid feedback from customers, and assemble small cross-functional teams to test ideas. Such practices are not necessarily costly, but they require psychological and organizational conditions in which workers can propose changes without automatic sanction for unsuccessful trials. Bagheri (2017) found that entrepreneurial leadership was associated with innovative work behavior and opportunity recognition among employees of high-technology SMEs in Iran. That evidence supports attention to employee-level mechanisms while not, by itself, proving a firm-level mediation effect.

Entrepreneurial leadership must also be differentiated from entrepreneurial orientation (EO). EO describes firm-level strategic tendencies, commonly including innovativeness, proactiveness, and risk taking, whereas entrepreneurial leadership concerns the influence behaviors through which individuals mobilize people around opportunities (Lumpkin & Dess, 1996; Renko et al., 2015). The constructs may correlate, particularly where the owner-manager strongly shapes strategy, but they should not be measured with interchangeable items. A study that treats leadership, EO, and innovation capacity as equivalent would make the proposed mediation conceptually circular.

2.2 Innovation capacity as a repeatable organizational capability

Innovation capacity describes what the organization is able to do rather than what its leader wants it to do. It may be manifested through routines for gathering market intelligence, absorbing external knowledge,

combining technical and commercial expertise, evaluating ideas, testing prototypes, reconfiguring work processes, and implementing improvements. Cohen and Levinthal (1990) argued that absorptive capacity rests partly on prior knowledge that enables organizations to recognize the value of external information, assimilate it, and use it. Zahra and George (2002) subsequently distinguished potential and realized absorptive capacity. These ideas help explain why exposure to the same market opportunity may produce markedly different results in different SMEs.

The distinction between inputs, processes, and outcomes is equally important. Investment in equipment or training can support innovation capacity, but expenditure alone does not establish it. A count of new products is an innovation outcome, not a complete measure of the underlying capacity. Crossan and Apaydin (2010) synthesized literature treating innovation as both a process and an outcome and identified organizational determinants including leadership. Building on this insight, the focal mediator is conceptualized as an integrated organizational capacity, evidenced by the reliable conversion of ideas and knowledge into feasible operational or market changes.

Innovation capacity should not be confused with "innovation management," although effective management may strengthen it. The former refers to an enduring capability; the latter encompasses the choices, structures, and practices used to direct innovation activities. A firm can establish an innovation committee yet lack the knowledge and routines needed to implement good ideas. Conversely, a small enterprise may have no formal innovation unit but still show strong capacity through disciplined experimentation, close customer interaction, and rapid learning. The mediator in the supplied model is therefore treated as a capability with observable organizational routines rather than a label for any activity involving novelty.

2.3 Organizational performance in SMEs

Organizational performance is broader than immediate profit. It can include financial outcomes such as revenue growth, return on assets, and cash-flow resilience; market outcomes such as customer retention, market share, and new-customer acquisition; and operational outcomes such as productivity, quality, lead time, and adaptability. Venkatraman and Ramanujam (1986) distinguished financial and wider operational conceptions of business performance, while Richard et al. (2009) argued that performance measures should be grounded in the relevant theory, stakeholders, and context. These distinctions are essential because a process innovation may initially increase costs but subsequently improve quality or delivery reliability.

SMEs often do not disclose audited financial information, leading researchers to use managerial self-reports. Perceptual growth measures can be informative if defined carefully, but they carry risks of recall error, social desirability, and common-method bias. Where possible, researchers should combine independently sourced financial indicators with nonfinancial evidence and compare firms over an appropriate period. The outcome construct in the present model is therefore multidimensional, with a distinction between short-term operating gains and longer-term financial or market performance. This avoids assuming that every beneficial innovation immediately appears in annual profit.

2.4 What prior evidence establishes—and what it does not

Empirical and conceptual studies offer convergent but incomplete reasons for expecting a leadership–capability–performance sequence. Koryak et al. (2015) integrated entrepreneurial leadership, substantive capabilities, dynamic capabilities, and firm growth, emphasizing the need to examine leadership alongside capability development. Huang et al. (2014) considered exploratory and exploitative innovation as mediators

of the entrepreneurial leadership–performance relationship in Chinese new ventures. Bagheri (2017) reported a relationship between entrepreneurial leadership and employees' opportunity recognition and innovative work behavior. Sawaean and Ali (2020) studied SMEs in Kuwait and found support for innovation capacity as a mediator in their broader model including learning orientation. These studies demonstrate that the three proposed constructs are theoretically and empirically related, although their samples, measures, and designs are not identical.

A caution is necessary: innovation is not a guaranteed performance multiplier. Rosenbusch et al. (2011) synthesized evidence across SMEs and showed that firm age, innovation type, and national context condition the innovation–performance relationship. Likewise, dynamic-capability theory does not imply that every reconfiguration creates value; firms may misread opportunities, allocate capital poorly, or pursue changes customers do not value (Teece, 2007). The paper therefore offers falsifiable propositions, not categorical forecasts. Any eventual study should permit null, heterogeneous, or negative effects rather than treating positive results as a prerequisite for confirming the framework's relevance.

3. Theoretical Foundations

3.1 Resource-based view: the value of distinctive internal capabilities

The resource-based view (RBV) argues that differences in resources and capabilities help explain why firms facing similar markets produce different performance outcomes. Barney (1991) emphasized resources that are valuable, rare, imperfectly imitable, and difficult to substitute as potential foundations of sustained advantage. Within the proposed model, entrepreneurial leadership can help coordinate a firm's knowledge, relationships, and human capabilities, but leadership alone is unlikely to confer durable advantage if its behaviors are not translated into distinctive organizational routines. Innovation capacity is a plausible mechanism for making those resources productive.

The RBV also highlights a tension relevant to small enterprises. A firm may have an imaginative owner-manager and skilled employees but fail to combine them effectively; conversely, modest resources may be deployed unusually well when organizational routines encourage knowledge sharing and experimentation. Sirmon et al. (2007) explicitly connected value creation to managers' structuring, bundling, and leveraging of resources. On this view, entrepreneurial leadership is a resource-orchestrating influence, innovation capacity is a bundled capability, and performance is a possible consequence of successfully leveraging that capability in markets.

Nevertheless, RBV does not establish the direction of causality by itself. Strong performance can attract better employees and finance innovation; resource abundance may also permit leadership behaviors that resource-poor enterprises cannot afford. The conceptual model identifies a theoretically plausible sequence but must not be mistaken for proof that leadership precedes capacity. Later research design recommendations address reverse causality and omitted variables.

3.2 Dynamic capabilities: converting opportunity into renewal

Dynamic-capability theory adds a temporal and environmental dimension to the resource explanation. Teece (2007) described sensing, seizing, and reconfiguring as important foundations of enterprise adaptation. Entrepreneurial leaders may create conditions for sensing opportunities by attending to weak market signals and diverse employee insights. They may enable seizing by committing resources to promising proposals, and they may support reconfiguration by challenging routines and coordinating change. Innovation capacity

becomes a firm-level vehicle for these processes; it determines whether opportunity-oriented leadership translates into repeatable adaptation rather than sporadic inspiration.

For SMEs, dynamic capabilities need not involve a formal research and development department. A small manufacturer might regularly solicit customer feedback, redesign a production sequence, and evaluate quality outcomes. A service SME might test a digital booking process, retrain employees, and adapt pricing after observing demand. The essential feature is the capacity to sense information, decide, implement, and learn. However, whether these routines yield superior outcomes depends on market demand, the cost of change, and the firm's execution ability. Dynamic capabilities explain adaptability; they do not make environmental or financial constraints disappear.

3.3 Strategic entrepreneurship and the leadership–innovation interface

Strategic entrepreneurship connects opportunity seeking with advantage seeking (Ireland et al., 2003). The perspective implies that recognizing new markets or technologies is insufficient unless firms organize resources to capture value. Entrepreneurial leaders can create shared purpose and mobilize initiative, while innovation capacity determines whether those initiatives develop into workable offerings or processes. In effect, the leader influences the direction and willingness to innovate; the organization supplies the routines for doing so reliably.

Taken together, the three perspectives create a layered explanation. RBV specifies why firm-specific capabilities may matter; dynamic-capability theory explains how enterprises renew those capabilities when markets change; and strategic entrepreneurship explains the combination of opportunity recognition and strategic exploitation. Their integration generates a mediated model that is conceptually more informative than a direct association between leadership style and aggregate financial performance. It also makes clear that leadership, capabilities, and outcomes occur at different analytical levels and should be measured accordingly.

4. Conceptual Model and Proposition Development

The model retains the three focal variables in the source framework. Entrepreneurial leadership (EL) is the independent construct, innovation capacity (IC) is the intervening organizational capability, and organizational performance (OP) is the outcome. The proposed arrows represent theoretical relationships rather than empirically estimated coefficients. A direct EL→OP pathway is included alongside the indirect EL→IC→OP pathway because leadership can affect performance through mechanisms other than innovation, such as coordination or customer responsiveness.

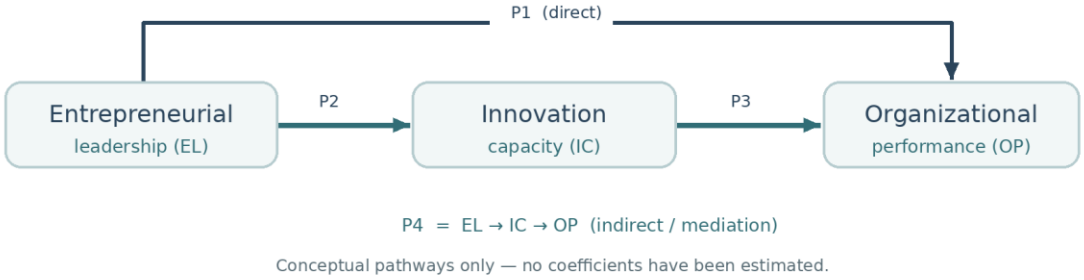


Figure 1. Proposed mediation framework (author-developed synthesis of the supplied framework).

4.1 Entrepreneurial leadership and organizational performance

Entrepreneurial leaders may improve performance by focusing scarce managerial attention on high-value opportunities and matching resources with strategic priorities. Opportunity-oriented communication can also help employees understand why changes are necessary and what outcomes the organization seeks. When owners or managers respond to market signals quickly, they may reduce delays, strengthen customer relationships, and avoid investments misaligned with demand. The RBV implies that these effects are meaningful when leadership improves the utilization of resources already available to the firm (Barney, 1991; Sirmon et al., 2007).

Evidence supporting a generally positive link comes from work on entrepreneurial leadership and firm growth (Koryak et al., 2015) and from broader entrepreneurship research relating strategic orientation to performance (Rauch et al., 2009). Nevertheless, leadership behavior and entrepreneurial orientation should remain analytically distinct. Moreover, a positive leadership–performance path should not be presumed to exclude costs: aggressive opportunity pursuit may overextend an SME or divert attention from essential operational control. The following proposition is a directional expectation conditional on reasonable resource discipline and opportunity quality, not a claim of universal benefit.

P1. Entrepreneurial leadership is positively associated with organizational performance in SMEs.

4.2 Entrepreneurial leadership and innovation capacity

Innovation capacity requires access to ideas as well as managerial willingness to evaluate and deploy them. Entrepreneurial leaders can strengthen this capacity by encouraging employees to observe customer problems, sharing information across functions, providing modest experimentation budgets, and treating unsuccessful trials as opportunities for disciplined learning. They can also develop external ties with buyers, suppliers, universities, and other firms to broaden knowledge inputs. Such practices address both the acquisition and practical exploitation of knowledge emphasized in absorptive-capacity theory (Cohen & Levinthal, 1990; Zahra & George, 2002).

At the team level, leadership may influence whether employees disclose potential improvements and invest effort in implementation. Bagheri (2017) provides relevant evidence linking entrepreneurial leadership to employees' innovative behavior and opportunity recognition. At the organizational level, however, individual creativity is only an input. Firms must codify learning, build shared routines, and allocate resources consistently if their innovation capacity is to improve. The proposed relationship therefore concerns the accumulation of reliable organizational capacity over time, not a one-off increase in employee enthusiasm.

P2. Entrepreneurial leadership is positively associated with innovation capacity in SMEs.

4.3 Innovation capacity and organizational performance

Innovation capacity may improve SME performance through several linked mechanisms. Product or service innovation can create differentiation, strengthen customer value, and open market segments. Process innovation can reduce waste, improve consistency, or shorten delivery times. Organizational innovation can support better knowledge transfer, coordination, or responsiveness. These benefits are consistent with evidence relating learning orientation and firm innovation capability to performance (Calantone et al., 2002), as well as work connecting knowledge-based resources with SME outcomes (Wiklund & Shepherd, 2003).

The performance pathway requires attention to timing and appropriation. An SME can innovate successfully in a technical sense but fail commercially because customers will not pay, costs are too high, or competitors imitate the offering. Furthermore, innovation capacity is an organizational asset with

maintenance costs: developing staff, retaining knowledge, and managing experimentation require time and funds. Rosenbusch et al. (2011) show why positive average findings cannot be converted into a guarantee for every enterprise. The conceptual expectation is that effective capacity, applied to valued opportunities and deployed with discipline, improves subsequent performance on average.

P3. Innovation capacity is positively associated with subsequent organizational performance in SMEs, conditional on effective commercialization or operational implementation.

4.4 Innovation capacity as a mediating mechanism

The mediating proposition connects the preceding relationships into a process. Entrepreneurial leadership establishes opportunity-focused direction and encourages initiative; innovation capacity converts those inputs into repeatable routines for acquiring, testing, implementing, and improving ideas; realized changes can then affect customer value, productivity, and performance. The indirect pathway is not merely a statistical convenience. It expresses a theory of how leadership actions can become economic outcomes through the development and deployment of organizational capabilities. This interpretation is consistent with the resource orchestration framework of Sirmon et al. (2007) and with capability-based discussions by Koryak et al. (2015).

The mediation proposition is also empirically plausible because related studies have considered innovation mechanisms. Huang et al. (2014) examined exploratory and exploitative innovation in the relationship between entrepreneurial leadership and new venture performance. Sawaean and Ali (2020) reported innovation capacity mediation in a Kuwaiti SME sample. The present framework retains a smaller set of variables to make the causal sequence easier to theorize and test across settings. It does not imply that innovation capacity is the only mediator, nor that the indirect effect must always be larger than the direct effect.

Conceptually, partial mediation is the more defensible starting point. Entrepreneurial leaders may improve customer responsiveness, employee coordination, and partnership development without first strengthening innovation capacity. Conversely, they may enhance capacity that produces results only in later periods. A future study should estimate the total, direct, and indirect effects separately and test whether the indirect effect is statistically distinguishable from zero, rather than declaring mediation from changes in significance alone (Preacher & Hayes, 2008).

P4. Innovation capacity mediates part of the positive relationship between entrepreneurial leadership and subsequent SME organizational performance.

4.5 Boundary conditions and rival explanations

Several conditions can strengthen or weaken the proposed paths. First, environmental dynamism can increase the value of rapid learning while also raising the risk of misjudging opportunities. Second, resource slack matters: firms with no capacity to finance prototypes or training may find it difficult to act on entrepreneurial visions. Third, innovation type matters because product, process, and organizational innovations carry different costs, time horizons, and appropriation opportunities. Fourth, firm age and sector shape whether innovations generate sufficient market returns (Rosenbusch et al., 2011; Teece, 2007).

Additional rival explanations deserve consideration. High-performing SMEs may be more able to hire entrepreneurial managers and fund innovation, implying reverse causality. Knowledge-intensive industries may exhibit both higher innovation capacity and higher growth independent of leadership. Founder ownership, access to finance, firm size, competition, market demand, and workforce skills can influence all three variables.

These factors are not added as primary nodes to the parsimonious source model, but they should be theorized as controls, moderators, or alternative pathways in future research rather than relegated to unexplained error.

5. Proposed Research Design for Empirical Testing

5.1 Research approach and unit of analysis

Because this is a conceptual paper, no new sample, statistical coefficient, significance test, or observed mediation result is reported. The most appropriate next step is a multi-wave, multi-source study of SMEs, preferably involving both manufacturing and service enterprises. The firm is the unit of analysis because innovation capacity and organizational performance are organizational constructs. Entrepreneurial leadership can be assessed from multiple employees within each firm and aggregated only after checking whether their perceptions show sufficient agreement. A single owner-manager response may be useful but should not automatically stand in for collective leadership perception.

A practical design would measure entrepreneurial leadership at Time 1, innovation capacity at Time 2, and business performance at Time 3, allowing a plausible interval for changes to occur. Where firm records exist, financial indicators should be observed across a baseline and follow-up period, while objective productivity or quality indicators can supplement them. The exact duration depends on industry cycles and innovation type. A cross-sectional survey could provide preliminary association estimates but would not establish the temporal sequence required by the proposed mediation mechanism.

5.2 Construct operationalization

Entrepreneurial leadership may be measured using items from the ENTRELEAD scale developed by Renko et al. (2015), with careful adaptation and validation for the industry and language of the sampled population. Innovation capacity should be measured using routines and capabilities such as knowledge acquisition, cross-functional learning, experimentation, idea implementation, and systematic evaluation, rather than only the number of new products. Organizational performance should incorporate relevant financial, market, and operational metrics, ideally gathered from different respondents and documents (Richard et al., 2009). The following table translates the theoretical constructs into candidate observations; the examples are not a new validated measurement scale.

Table 1. Construct definitions and illustrative future-study indicators

Entrepreneurial leadership (EL)	Leaders' influence directed toward opportunity identification and exploitation.	Opportunity-focused vision; mobilization of others; proactive support; empowerment; calculated experimentation.
Innovation capacity (IC)	Firm-level routines for acquiring and converting knowledge into feasible innovations.	External knowledge acquisition; idea screening; learning integration; experimentation; implementation; improvement cycles.
Organizational performance (OP)	Financial, market, and operational outcomes appropriate to SME context.	Sales / profit growth; customer retention; productivity; quality; cycle time; survival or resilience.

5.3 Model estimation and robustness

A future analysis can use structural equation modeling or appropriately specified regression-based path models, depending on sample size, measurement properties, and study design. The key indirect effect is the product of the EL→IC coefficient and the IC→OP coefficient, with the remaining direct EL→OP association assessed separately. Bias-corrected or percentile bootstrap confidence intervals offer a more defensible assessment of the indirect effect than inferring mediation solely from the significance or nonsignificance of

individual paths (Preacher & Hayes, 2008). Measurement reliability, discriminant validity, and the suitability of aggregating individual responses should be evaluated before testing structural propositions.

Robustness checks should include alternative performance measures, lag lengths, firm size and age, industry differences, baseline performance, and possible nonlinear relationships. Reverse pathways merit explicit tests where data permit, particularly OP→IC and OP→EL. To reduce common-method bias, leadership ratings should come from employees, innovation capacity from process or innovation managers where possible, and performance from records or separate informants. Procedural safeguards and statistical diagnostics should follow the principles discussed by Podsakoff et al. (2003). These safeguards cannot remove all endogeneity, but they improve the credibility of causal interpretations.

5.4 Research context and ethical considerations

The framework is relevant to SME contexts such as Pakistan, but it would be premature to claim that its magnitudes or mediation pattern have already been established there. Industry structure, informality, external knowledge access, and the availability of finance may affect the feasibility of developing innovation capacity. A future study should define an SME using an explicit, jurisdiction-appropriate standard and document its sampling frame. It should also report whether enterprises are family-owned, export-oriented, technology intensive, or operating in highly competitive markets. Those characteristics may account for variation in leadership and innovation processes.

Participation should be voluntary, with confidential treatment of revenue records and employee evaluations. Firms should not be ranked or publicly identified without permission. A pre-registered analysis plan that distinguishes primary propositions from exploratory moderators would reduce the temptation to present post hoc relationships as predicted findings. If translated scales are used, researchers should document translation, back-translation, pilot testing, and whether constructs function equivalently across relevant groups.

6. Discussion and Implications

6.1 Theoretical implications

The model clarifies the distinction between a leader's opportunity-oriented influence and the firm's actual ability to innovate. Leadership is proposed as a source of direction and resource mobilization; innovation capacity is the organizational mechanism that transforms selected opportunities into executable changes; performance is an outcome that depends on the market and operational value of those changes. This division reduces conceptual overlap and makes it possible to ask whether organizational routines explain more of the performance relationship than leadership alone. It also integrates the RBV, dynamic-capability theory, and strategic entrepreneurship without assuming that those perspectives are interchangeable.

The model's key contribution is not a claim of first discovery. Prior research has already examined related direct and mediated pathways, especially Sawaean and Ali (2020). Rather, the contribution lies in articulating a narrower causal mechanism, specifying how to distinguish capability from innovation outputs, and highlighting where favorable leadership behavior may fail to generate business benefits. The proposed temporal ordering and multi-source measurement approach can help move future research from cross-sectional correlation toward more credible explanations of capability development.

6.2 Managerial implications for SMEs

For SME managers, the principal implication is to translate entrepreneurial ambition into repeatable innovation routines. Articulating a growth vision is insufficient if employees cannot report ideas, learn from

customers, test feasible alternatives, and implement improvements. Managers can begin with small-scale practices: scheduled customer-feedback reviews, visible criteria for evaluating ideas, cross-functional problem-solving sessions, and post-implementation assessments of quality, cost, and customer responses. These routines support capability development without assuming every SME can maintain a formal research department.

Managers should also protect essential operating capacity. Innovation activity should be matched to available finance, employee time, and customer need. A disciplined portfolio may combine incremental process improvement with a smaller number of exploratory projects. When an innovation initiative does not yield a return, the organization should capture the learning rather than inflate its performance claims. The framework thus supports entrepreneurial leadership coupled with evidence-based resource allocation, not unrestricted risk taking.

6.3 Implications for SME support institutions

Policy and business-support institutions can help entrepreneurs develop capabilities instead of focusing exclusively on encouraging startup creation or providing one-off grants. Training programs may combine leadership development with practical skills in market testing, process improvement, collaborative problem solving, and external knowledge acquisition. Industry associations and university–SME partnerships can facilitate access to technical expertise, while tailored advisory services can help firms evaluate innovation expenditures against realistic implementation capacity. Such measures follow the theoretical emphasis on knowledge absorption and capability deployment (Cohen & Levinthal, 1990; Zahra & George, 2002).

Program evaluations should examine more than participation counts or the number of workshops offered. Relevant indicators include changes in firms' innovation routines, adoption of useful processes, customer outcomes, and later financial or operational performance. Because benefits are context dependent, support schemes should distinguish microenterprises from larger SMEs, manufacturing from services, and mature firms from newly established ventures. Evidence from one country or sector should not automatically be generalized to another.

7. Limitations and Future Research Agenda

The paper is a theoretical synthesis grounded in a supplied research framework and pre-2023 scholarly literature; it is not a systematic review, meta-analysis, or original empirical test. Its positive propositions reflect expected relationships under plausible conditions and should not be interpreted as established causal facts in Pakistan or any other jurisdiction. It focuses on one mediator, although learning orientation, employee engagement, organizational culture, digital competence, and external networks may provide alternative or complementary explanations. Future work should compare models without mechanically expanding the framework until it becomes uninterpretable.

Further research could investigate whether the mediation process differs between manufacturing and services, younger and mature SMEs, or firms facing high and low environmental dynamism. Studies might examine whether innovation capacity takes longer to affect financial than operational indicators, whether resource scarcity imposes a threshold below which leadership has little effect, and whether incremental innovation yields more consistent near-term gains than radical innovation. Comparative research should also consider national institutional conditions, financing arrangements, and market structure. These questions are particularly valuable because aggregate positive associations may conceal important variation (Rosenbusch et al., 2011).

Finally, qualitative fieldwork can illuminate how leaders actually develop innovation routines and how employees interpret entrepreneurial expectations. Longitudinal case studies would be useful for tracing decisions, failures, and adaptations that survey instruments rarely capture. Mixed-method research can then connect process explanations with multi-wave quantitative tests, clarifying both whether the mediation exists and when it produces measurable value. This research program offers a more rigorous progression than treating the absence of a statistically significant direct effect as sufficient proof of mediation.

8. Conclusion

Entrepreneurial leadership can orient SMEs toward opportunities, but organizational performance depends on more than the quality of a leader's vision. The central argument of this conceptual paper is that innovation capacity provides a plausible organizational channel through which opportunity-oriented influence becomes repeatable learning, implementation, and value creation. The proposed model therefore contains both a direct entrepreneurial leadership–performance pathway and an indirect path through innovation capacity. Four propositions articulate these relationships while explicitly acknowledging contextual limits.

Drawing on resource-based theory, dynamic-capability theory, and strategic entrepreneurship, the analysis shows why capability development should be distinguished from individual leadership behaviors and from isolated innovation outcomes. The framework is suitable for future testing in SMEs, including enterprises in Pakistan, but it does not establish any new empirical effects. Its practical message is equally clear: sustainable performance is more likely when entrepreneurial direction is supported by routines that transform knowledge and ideas into customer-relevant, operationally feasible changes. Testing that explanation with longitudinal and multi-source evidence is the next task for research.

Disclosure Statement

Conflict of Interest

The authors declare that they have no financial, professional, technological, commercial, institutional, or personal conflicts of interest that could have influenced the content, interpretation, or conclusions presented in this article.

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Data Availability

No new clinical, experimental, or patient-level datasets were generated or analysed during this study. All information discussed in the review was obtained from the published literature and publicly available sources cited in the manuscript. Additional information relating to the review may be obtained from the corresponding author upon reasonable request.

Informed Consent

Not applicable. No patients or other human participants were recruited, and no identifiable personal or clinical information was collected or analysed for this review.

Use of Generative AI

Consistent with the guidance of Egan et al. (2025), we disclose that ChatGPT (OpenAI) was used solely for copyediting and language refinement purposes to improve clarity, readability, grammar, sentence structure, and consistency of expression. All substantive aspects of the study, including

the conceptualization of the research idea, theorization, development of the research model, methodology, data analysis, interpretation of findings, and development of conclusions, were independently conducted and reported by the authors.

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