



Entrepreneurial Leadership and SME Performance: Examining the Mediating Role of Innovation Capability

Mariah¹, Yuswari Nur, Faisal Rizal Zainal¹

¹Institut Teknologi dan Bisnis Nobel Indonesia

*Corresponding Author: Mariah

Email: mariah@stienobel-indonesia.ac.id



Article Info

Article history:

Received 10 June 2026

Received in revised form 20

July 2026

Accepted 21 August 2026

Keywords:

Entrepreneurial leadership

Innovation Capability

SME Performance

Resource-Based View

Dynamic Capability Theory

JEL Classification:

L26; O31; L25; M12; M13

Abstract

This study examined the effect of entrepreneurial leadership on SME performance through the mediating role of innovation capability among Micro, Small, and Medium Enterprises (SMEs) in Makassar City, Indonesia. A quantitative approach with an explanatory research design was employed. Data were collected from 80 SME owners and managers using purposive sampling and analyzed using Partial Least Squares Structural Equation Modeling (PLS-SEM) with SmartPLS 4. The results revealed that entrepreneurial leadership positively and significantly affects innovation capability and SME performance. Innovation capability also has a positive and significant effect on SME performance and significantly mediates the relationship between entrepreneurial leadership and SME performance. These findings indicate that entrepreneurial leadership contributes to improved business performance both directly and indirectly through the development of innovation capability. The study concludes that innovation capability serves as an important mechanism linking entrepreneurial leadership to SME performance. The findings support the Resource-Based View and Dynamic Capability Theory and provide empirical evidence on the importance of entrepreneurial leadership and innovation capability in enhancing SME performance.

Introduction

Micro, Small, and Medium Enterprises (MSMEs) play a vital role in stimulating economic activity and creating employment opportunities across many countries, including Indonesia (Mahfud, 2025; Zainuri et al., 2025; Haryono et al., 2026). In recent years, increasing attention has been directed toward MSME development as business environments become more dynamic and competitive. Rapid technological advancements, changing consumer preferences, and intensifying market competition require MSMEs not only to survive but also to achieve sustainable growth and long-term competitiveness. In this context, business performance has become a critical indicator reflecting an organization's ability to manage resources effectively, respond to environmental changes, and achieve its strategic objectives. Consequently, understanding the factors that contribute to improving MSME performance has emerged as an important issue in contemporary management and entrepreneurship research (Nguyen et al., 2021; Khan et al., 2024).

Despite their strategic contribution to economic development, many MSMEs continue to face substantial challenges in enhancing their business performance (Hasyim & Bakri, 2025; Martinravi & Krishnasamy, 2025; Hermansyah et al., 2025). An increasingly competitive business environment requires firms to adapt rapidly to market changes, develop products that meet evolving customer needs, and establish sustainable competitive advantages. However, not all MSMEs possess the same capacity to cope with these challenges. While some firms

demonstrate significant growth and resilience, others struggle to maintain their operations and sustain performance over time. These disparities suggest that business success is influenced not only by external environmental factors but also by internal organizational capabilities that enable firms to effectively manage and leverage their available resources (Taleb et al., 2023; Isa et al., 2024).

From a strategic management perspective, organizational success is largely determined by internal factors that create value and generate competitive advantage (Mesut, 2026; Satar et al., 2025; Obeng et al., 2025; Wang et al., 2025). Among these factors, leadership has received considerable attention in entrepreneurship literature. Within MSMEs, owners or managers often serve as the primary decision-makers responsible for determining the direction and development of the business. As a result, leadership characteristics and behaviors play a crucial role in shaping an organization's ability to respond to environmental changes and business challenges. Effective leadership extends beyond managing day-to-day operations; it also involves identifying opportunities, initiating change, and guiding organizations toward sustainable growth and development (Akbari et al., 2020).

One leadership approach that has gained increasing prominence in entrepreneurship research is entrepreneurial leadership (Ahmed & Harrison, 2025; Chandranathan2025; Ibrahim et al., 2024). This concept emphasizes a leader's ability to recognize business opportunities, take calculated risks, encourage creativity, and foster an organizational culture that is adaptive to change. Entrepreneurial leadership is considered particularly relevant in uncertain and dynamic business environments because it integrates entrepreneurial orientation with leadership functions. Akbari et al. (2020) found that entrepreneurial leadership promotes innovative work behavior through enhanced creative self-efficacy and support for innovation. These findings indicate that entrepreneurial leadership has the potential to create conditions that facilitate organizational development and strengthen business competitiveness (Razzaque et al., 2024; Otache & Onuh, 2026; Ataei et al., 2024).

The relationship between entrepreneurial leadership and business performance has attracted substantial scholarly attention in recent years (Hoang et al., 2025; Shiferaw et al., 2023; Al-Sharif et al., 2023). Nguyen et al. (2021) found that entrepreneurial leadership contributes to improved business performance through various organizational factors that enhance management effectiveness. Similarly, Khan et al. (2024) reported that entrepreneurial leadership serves as a significant driver of MSME performance. Furthermore, Murtini et al. (2024) demonstrated that entrepreneurial leadership is positively associated with MSME performance when supported by other strategic factors, such as entrepreneurial networking and innovation capability. Nevertheless, previous studies also suggest that the influence of entrepreneurial leadership on business performance does not always occur directly, indicating the need for a deeper understanding of the mechanisms through which leadership affects organizational outcomes.

In dynamic business environments, innovation capability has emerged as a critical factor in explaining how organizations create and sustain competitive advantage. Innovation capability refers to an organization's ability to generate, develop, and implement new ideas, products, processes, and methods that create value for both customers and the organization. The importance of innovation capability has increased significantly as organizations can no longer rely solely on existing resources but must continuously transform those resources into market-relevant solutions. Purwati et al. (2021) found that innovation capability contributes significantly to MSME business performance by enhancing value creation and operational

effectiveness. Similarly, Isa et al. (2024) emphasized that innovation capability is a key determinant of MSME success in responding to increasingly dynamic business environments.

The relationship between entrepreneurial leadership and innovation capability can be understood through the role of leaders in fostering a learning-oriented environment that encourages creativity and the exploration of new opportunities. Leaders with an entrepreneurial orientation tend to motivate organizational members to develop innovative ideas, experiment with alternative solutions, and proactively address business challenges. Consequently, entrepreneurial leadership has the potential to strengthen organizational innovation capability, which in turn contributes to improved business performance. Taleb et al. (2023) found that innovation capability functions as an important mechanism linking entrepreneurial resources to business performance. This finding suggests that organizational performance depends not only on the availability of strategic resources but also on an organization's ability to manage and utilize those resources through innovation processes.

Theoretically, the relationship among entrepreneurial leadership, innovation capability, and MSME performance can be explained through the Resource-Based View (RBV) and Dynamic Capability Theory. The Resource-Based View argues that organizations achieve competitive advantage through valuable, rare, inimitable, and non-substitutable resources. In this study, entrepreneurial leadership is viewed as a strategic resource that provides direction and capability for identifying and exploiting business opportunities. However, the possession of strategic resources alone is insufficient to generate superior performance. Dynamic Capability Theory suggests that organizations must possess the ability to integrate, build, and reconfigure their resources in response to changing environmental conditions. Therefore, innovation capability can be conceptualized as a dynamic capability that enables organizations to transform the potential of entrepreneurial leadership into tangible performance outcomes (Purwati et al., 2021; Taleb et al., 2023).

Although the relationships among entrepreneurial leadership, innovation capability, and business performance have received considerable attention in the literature, previous studies have reported mixed findings. Some studies found a direct positive effect of entrepreneurial leadership on business performance (Nguyen et al., 2021; Khan et al., 2024), while others suggested that this relationship operates through mediating variables, including innovation capability (Sawaeen & Ali, 2020; Taleb et al., 2023). Moreover, most previous studies have been conducted in different organizational and geographical contexts, highlighting the need for more context-specific empirical evidence, particularly within Indonesian MSMEs. Research examining innovation capability as the mediating mechanism linking entrepreneurial leadership and MSME performance remains relatively limited, thereby creating an opportunity to contribute both empirically and theoretically to the entrepreneurship literature.

Based on the foregoing discussion, this study aims to examine the effect of entrepreneurial leadership on MSME performance by positioning innovation capability as a mediating variable. The study seeks to provide a more comprehensive understanding of the mechanisms through which entrepreneurial leadership influences business performance while enriching the literature on the role of innovation capability within the MSME context. In addition to contributing to theoretical development, the findings are expected to offer practical implications for MSME owners and managers in developing leadership practices that foster innovation and enhance sustainable business performance.

Method

This study employed a quantitative approach with an explanatory research design to examine the relationship between entrepreneurial leadership, innovation capability, and SME performance. Grounded in the Resource-Based View (RBV) and Dynamic Capability Theory, the study investigated the direct effect of entrepreneurial leadership on SME performance and the mediating role of innovation capability in explaining this relationship.

The study targeted Micro, Small, and Medium Enterprises (SMEs) operating in Makassar City, Indonesia. Respondents consisted of SME owners or managers who were actively involved in strategic and operational decision-making and possessed sufficient knowledge regarding leadership practices, innovation activities, and business performance. A purposive sampling technique was employed, whereby respondents were required to meet the following criteria: (1) being an SME owner or manager, (2) actively participating in business decision-making, (3) operating the business for at least two years, and (4) being willing to complete the questionnaire.

The sample size was determined using an a priori statistical power analysis conducted with G*Power 3.1. Following Faul et al. (2009), the analysis used a significance level (α) of 0.05, statistical power of 0.80, and a medium effect size (f^2) of 0.15. The results indicated a minimum sample requirement of 77 respondents. Therefore, this study employed 80 SME owners and managers as respondents, which exceeded the minimum threshold required for Partial Least Squares Structural Equation Modeling (PLS-SEM).

Data were collected through a structured questionnaire distributed both online and offline. The questionnaire consisted of items measuring entrepreneurial leadership, innovation capability, and SME performance using a five-point Likert scale ranging from 1 (strongly disagree) to 5 (strongly agree). The operational definitions and measurement indicators of the variables are presented in Table 1.

Table 1. Operational Definition of Variables

Variable	Operational Definition	Indicators	Scale	Source
Entrepreneurial Leadership (X)	The ability of leaders to identify opportunities, take calculated risks, encourage innovation, and direct the organization toward achieving its objectives through entrepreneurial behaviors.	1. Opportunity recognition 2. Visionary behavior 3. Proactiveness 4. Risk-taking 5. Creativity encouragement	Likert 1–5	Renko et al. (2015)
Innovation Capability (M)	The organization's ability to generate, develop, and implement new ideas, products, processes, or methods that create value and enhance business competitiveness.	1. Ability to develop new products 2. Ability to improve business processes 3. Ability to generate innovative ideas 4. Ability to adapt	Likert 1–5	Purwati et al. (2021); Taleb et al. (2023)

		to change5. Ability to implement innovation		
SME Performance (Y)	The extent to which a business achieves its objectives, reflected in growth and business achievements over a certain period.	1. Sales growth2. Profit growth3. Customer growth4. Market share growth5. Overall business performance	Likert 1–5	Nguyen et al. (2021); Purwati et al. (2021)

Data were analyzed using Partial Least Squares Structural Equation Modeling (PLS-SEM) with SmartPLS 4 software. PLS-SEM was selected because it is suitable for predictive research, theory development, and mediation analysis, particularly with relatively small sample sizes (Hair et al., 2022). The analysis involved evaluating both the measurement and structural models. The measurement model was assessed through convergent validity using outer loadings (> 0.70) and Average Variance Extracted ($AVE > 0.50$), reliability using Cronbach's Alpha, Composite Reliability (CR), and ρ_A (> 0.70), and discriminant validity using the Heterotrait-Monotrait Ratio ($HTMT < 0.90$). The structural model was evaluated using Variance Inflation Factor ($VIF < 5$), coefficient of determination (R^2), predictive relevance (Q^2), effect size (f^2), and Standardized Root Mean Square Residual ($SRMR < 0.08$). Hypothesis testing was conducted through bootstrapping with 5,000 subsamples, where hypotheses were accepted when the t-value exceeded 1.96 and the p-value was below 0.05. The mediating role of innovation capability was examined through indirect effect analysis to determine whether it significantly mediated the relationship between entrepreneurial leadership and SME performance.

Results and Discussion

Respondent Characteristics

A total of 80 SME owners and managers in Makassar City participated in this study. The respondents were selected using purposive sampling based on predetermined criteria, including active involvement in business decision-making and a minimum business operation period of two years. The demographic profile of respondents is presented in Table 2.

Table 2. Respondent Characteristics

Characteristics	Frequency	Percentage (%)
Gender		
Male	43	53.8
Female	37	46.2
Total	80	100.0
Age		
20–30 years	18	22.5
31–40 years	29	36.3
41–50 years	21	26.2
>50 years	12	15.0
Total	80	100.0
Business Experience		
2–5 years	24	30.0
6–10 years	31	38.8

>10 years	25	31.2
Total	80	100.0
Business Sector		
Food and Beverage	28	35.0
Fashion and Craft	17	21.3
Retail Trade	15	18.7
Services	12	15.0
Others	8	10.0
Total	80	100.0

Source: Processed primary data (2026).

Table 2 shows that male respondents slightly dominated the sample, accounting for 53.8% of the total respondents, while female respondents represented 46.2%. Most respondents were between 31 and 40 years old (36.3%), indicating that the majority were within a productive entrepreneurial age group. In terms of business experience, most respondents had operated their businesses for six to ten years (38.8%), suggesting adequate managerial and entrepreneurial experience. Based on business sector, food and beverage businesses constituted the largest proportion of the sample (35.0%), followed by fashion and craft businesses (21.3%), retail trade (18.7%), service businesses (15.0%), and other sectors (10.0%).

Measurement Model Evaluation

The measurement model was evaluated by assessing indicator reliability, convergent validity, internal consistency reliability, and discriminant validity. The final structural model generated using SmartPLS 4 is presented in Figure 1. The figure illustrates the relationships among Entrepreneurial Leadership, Innovation Capability, and SME Performance, including the outer loading values of each indicator, the path coefficients among constructs, and the coefficient of determination (R^2) values for the endogenous variables. Overall, the model indicates positive relationships among the proposed constructs and satisfactory indicator loadings.

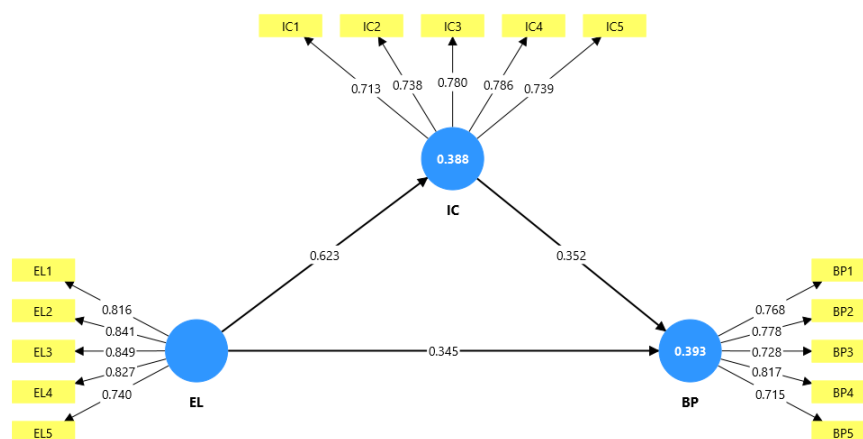


Figure 1. Structural Model Results

Figure 1 depicts the final structural model estimated using SmartPLS 4. The model displays the relationships among Entrepreneurial Leadership, Innovation Capability, and SME Performance, including the outer loading values of the indicators, path coefficients, and coefficients of determination (R^2). Overall, the model provides preliminary evidence that the proposed relationships are positive and that the indicators adequately reflect their respective

constructs. To further validate the measurement model, an assessment of indicator reliability, convergent validity, internal consistency reliability, and discriminant validity was conducted. The results of the outer loading analysis are presented in Table 3.

Table 3. Outer Loading

Variables	Indicator	Outer Loading	Information
Entrepreneurial Leadership	EL1	0.816	Valid
	EL2	0.841	Valid
	EL3	0.849	Valid
	EL4	0.827	Valid
	EL5	0.740	Valid
Innovation Capability	IC1	0.713	Valid
	IC2	0.738	Valid
	IC3	0.780	Valid
	IC4	0.786	Valid
	IC5	0.739	Valid
SME Performance	BP1	0.768	Valid
	BP2	0.778	Valid
	BP3	0.728	Valid
	BP4	0.817	Valid
	BP5	0.715	Valid

Source: SmartPLS 4 data processing results (2026).

The results indicate that all indicators achieved outer loading values above the recommended threshold of 0.70. Therefore, all indicators were considered valid and retained for further analysis. The highest loading value was observed for EL3 (0.849), while the lowest loading value was recorded for IC1 (0.713), both of which remained within acceptable limits.

To assess convergent validity and reliability, Average Variance Extracted (AVE), Composite Reliability (CR), and Cronbach's Alpha were examined. The results are presented in Table 4.

Table 4. Construct Reliability and Validity

Variables	AVE	Composite Reliability	Cronbach's Alpha
Entrepreneurial Leadership	0.665	0.908	0.874
Innovation Capability	0.565	0.866	0.807
SME Performance	0.580	0.873	0.819

Source: SmartPLS 4 data processing results (2026).

The results show that all constructs achieved AVE values above 0.50, Composite Reliability values above 0.70, and Cronbach's Alpha values above 0.70. These findings confirm that all constructs satisfy the recommended criteria for convergent validity and internal consistency reliability. To further assess discriminant validity, the Fornell-Larcker Criterion was employed. The results are presented in Table 5.

Table 5. Fornell-Larcker Criterion

Variables	BP	EL	IC
SME Performance	0.762		
Entrepreneurial Leadership	0.564	0.816	
Innovation Capability	0.566	0.623	0.752

Source: SmartPLS 4 data processing results (2026).

The results indicate that the square root of AVE for each construct exceeds the correlations between constructs. Therefore, discriminant validity is established. In addition, HTMT values ranged from 0.654 to 0.734, which are below the recommended threshold of 0.90, further confirming that the constructs are empirically distinct.

Structural Model Evaluation

Before testing the hypotheses, the structural model was evaluated through the coefficient of determination (R^2), effect size (f^2), and model fit assessment.

Table 6. Coefficient of Determination (R^2)

Endogenous Variable	R^2	Category
Innovation Capability	0.388	Moderate
SME Performance	0.393	Moderate

Source: SmartPLS 4 data processing results (2026).

The results indicate that Entrepreneurial Leadership explains 38.8% of the variance in Innovation Capability. Furthermore, Entrepreneurial Leadership and Innovation Capability jointly explain 39.3% of the variance in SME Performance. According to the guidelines of PLS-SEM, both values indicate a moderate level of explanatory power.

Table 7. Effect Size (f^2)

Variable Relationship	f^2	Category
Entrepreneurial Leadership → Innovation Capability	0.633	Large
Entrepreneurial Leadership → SME Performance	0.120	Small–Moderate
Innovation Capability → SME Performance	0.125	Small–Moderate

Source: SmartPLS 4 data processing results (2026).

The effect size analysis indicates that Entrepreneurial Leadership exerts a substantial influence on Innovation Capability. Meanwhile, Entrepreneurial Leadership and Innovation Capability have small-to-moderate contributions to SME Performance. Model fit was evaluated using the Standardized Root Mean Square Residual (SRMR).

Table 8. Model Fit Assessment

Indicator	Value
SRMR	0.077

Source: SmartPLS 4 data processing results (2026).

The SRMR value of 0.077 is below the recommended threshold of 0.08, indicating that the proposed model demonstrates an acceptable level of fit.

Hypothesis Testing

Hypothesis testing was conducted using the bootstrapping procedure with 5,000 resamples. A relationship was considered significant when the T-statistic exceeded 1.96 and the p-value was below 0.05.

Table 9. Direct Effects

Relationship	β	T-Statistic	p-value	Result
Entrepreneurial Leadership → Innovation Capability	0.623	9.807	0.000	Significant
Innovation Capability → SME Performance	0.352	2.909	0.004	Significant
Entrepreneurial Leadership → SME Performance	0.345	3.105	0.002	Significant

Source: SmartPLS 4 data processing results (2026).

The results indicate that Entrepreneurial Leadership has a positive and significant effect on Innovation Capability ($\beta = 0.623$, $p < 0.001$). Therefore, H1 is supported. This finding suggests that entrepreneurial leaders contribute to strengthening innovation capability within SMEs. Innovation Capability also has a positive and significant effect on SME Performance ($\beta = 0.352$, $p = 0.004$), supporting H2. This result implies that SMEs with stronger innovation capability tend to achieve higher business performance. Furthermore, Entrepreneurial Leadership positively and significantly influences SME Performance ($\beta = 0.345$, $p = 0.002$). Therefore, H3 is supported, indicating that entrepreneurial leadership directly contributes to improved business performance.

Mediation Analysis

To examine the mediating role of Innovation Capability, an indirect effect analysis was performed using the bootstrapping procedure.

Table 10. Indirect Effect

Indirect Relationship	β	T-Statistic	p-value	Result
Entrepreneurial Leadership → Innovation Capability → SME Performance	0.219	2.763	0.006	Significant

Source: SmartPLS 4 data processing results (2026).

The results indicate that the indirect effect of Entrepreneurial Leadership on SME Performance through Innovation Capability is positive and statistically significant ($\beta = 0.219$, $p = 0.006$). Therefore, H4 is supported.

Since both the direct effect of Entrepreneurial Leadership on SME Performance and the indirect effect through Innovation Capability are significant, Innovation Capability serves as a partial mediator in the proposed model. This finding suggests that entrepreneurial leadership enhances SME performance both directly and indirectly by strengthening the organization's capability to develop and implement innovation.

Overall, the findings confirm that Entrepreneurial Leadership is a critical determinant of SME Performance and that Innovation Capability functions as an important mechanism through which entrepreneurial leadership contributes to organizational success

Entrepreneurial Leadership and Innovation Capability

The results indicate that entrepreneurial leadership has a positive and significant effect on innovation capability. This finding suggests that SME owners or managers who demonstrate entrepreneurial leadership characteristics, such as opportunity recognition, proactiveness, risk-taking, and visionary behavior, are more capable of fostering innovation within their

organizations. Entrepreneurial leaders create an environment that encourages experimentation, learning, and the development of new ideas, thereby enhancing the organization's ability to innovate. The large effect size observed in this study further confirms that entrepreneurial leadership serves as an important driver of innovation capability among SMEs.

In the context of SMEs in Makassar City, entrepreneurial leadership becomes particularly important because many businesses operate in highly competitive markets and face rapid changes in customer preferences, technological developments, and market trends. SME leaders who proactively identify business opportunities and encourage innovative thinking are more likely to stimulate the development of new products, improve business processes, and adapt their organizations to environmental changes. As a result, entrepreneurial leadership creates conditions that support continuous innovation and organizational learning.

This finding supports the Resource-Based View (RBV), which argues that valuable organizational resources can generate competitive advantages when effectively leveraged. In this context, entrepreneurial leadership represents a strategic intangible resource that enables firms to identify and exploit opportunities for innovation. The result is also consistent with Dynamic Capability Theory, which emphasizes the importance of organizational capabilities in responding to environmental changes and market uncertainty. SMEs led by entrepreneurial leaders are more likely to develop innovation capability as a mechanism for adapting to changing business conditions and sustaining competitiveness.

Empirically, the findings are consistent with Akbari et al. (2021), who reported that entrepreneurial leadership promotes innovative behavior through creativity and support for innovation. The results also support Jundulloh and Nasution (2024), who found that entrepreneurial leadership contributes significantly to innovation capability and sustainable organizational performance among Indonesian SMEs. Similarly, Annur et al. (2025) demonstrated that entrepreneurial leadership plays a critical role in strengthening innovation capability, which subsequently improves SME performance. Therefore, the findings of this study reinforce the argument that entrepreneurial leadership is a key antecedent of innovation capability within SMEs.

Innovation Capability and SME Performance

The findings reveal that innovation capability positively and significantly influences SME performance. This result indicates that SMEs possessing stronger capabilities in developing new products, improving operational processes, adapting to market changes, and implementing innovative ideas tend to achieve superior business performance. Innovation capability enables firms to create value, differentiate themselves from competitors, and respond effectively to customer needs, thereby enhancing organizational performance.

For SMEs operating in dynamic business environments, innovation capability functions as an essential mechanism for maintaining competitiveness and responding to evolving customer demands. Businesses that continuously improve products, services, and operational processes are more likely to strengthen customer satisfaction, expand market opportunities, and improve financial performance. Consequently, innovation capability becomes a critical factor in supporting sustainable business growth.

From the perspective of Dynamic Capability Theory, innovation capability represents a strategic capability that allows organizations to reconfigure resources and adapt to environmental changes. Firms that continuously innovate are more likely to maintain competitiveness and achieve sustainable performance. In highly dynamic business

environments, innovation capability becomes a critical determinant of long-term organizational success.

Although the effect of innovation capability on SME performance is statistically significant, the magnitude of the coefficient indicates that innovation capability is not the only determinant of business performance. This finding suggests that other factors, such as entrepreneurial orientation, market orientation, digital capability, managerial competence, and external support, may also contribute to SME performance. Therefore, innovation capability should be viewed as one of several strategic capabilities that collectively influence organizational outcomes.

This finding is in line with Purwati et al. (2021), who found that innovation capability significantly improves business performance among Indonesian SMEs. The result also supports Taleb et al. (2023), who identified innovation capability as a key factor influencing micro-business performance. Furthermore, Annur et al. (2025) reported that innovation capability contributes positively to MSME performance and serves as an important mechanism for transforming organizational resources into performance outcomes.

Entrepreneurial Leadership and SME Performance

The results further demonstrate that entrepreneurial leadership positively and significantly affects SME performance. This finding indicates that entrepreneurial leaders contribute directly to organizational success through strategic decision-making, opportunity recognition, proactive behavior, and the ability to mobilize organizational resources effectively. Entrepreneurial leaders are better positioned to navigate uncertainty, identify emerging opportunities, and develop strategies that enhance business growth and competitiveness.

Unlike large organizations that possess more formal managerial structures, SMEs generally rely heavily on the owner or manager as the primary decision maker. Consequently, the leadership style adopted by SME leaders has a direct impact on organizational performance because strategic and operational decisions are often centralized in a single individual. Leaders who exhibit entrepreneurial characteristics are more capable of responding to market challenges, identifying growth opportunities, and motivating organizational members to achieve business objectives.

The findings support the Resource-Based View, which considers leadership a valuable organizational resource capable of generating superior performance. Entrepreneurial leadership helps SMEs develop a clear strategic direction while encouraging adaptability and responsiveness to environmental changes. As a result, firms led by entrepreneurial leaders are more likely to achieve better performance outcomes and sustain their competitive position in the market.

This finding is consistent with Nguyen et al. (2021), who found that entrepreneurial leadership positively influences SME performance. Similarly, Khan et al. (2024) reported that entrepreneurial leadership is a key determinant of SME performance through the development of entrepreneurial competencies and organizational capabilities. Within the Indonesian context, Umamy and Nuha (2025) also found that entrepreneurial leadership significantly contributes to the performance of MSMEs by improving managerial effectiveness and organizational adaptability. Collectively, these findings strengthen the argument that entrepreneurial leadership is a critical factor in enhancing SME performance.

The Mediating Role of Innovation Capability

One of the most important findings of this study is that innovation capability significantly mediates the relationship between entrepreneurial leadership and SME performance. The mediation analysis indicates that entrepreneurial leadership not only affects performance directly but also indirectly through the enhancement of innovation capability. This result suggests that entrepreneurial leaders improve organizational performance by creating conditions that facilitate innovation and encourage the development of new products, services, and business processes.

The finding provides strong support for Dynamic Capability Theory. While entrepreneurial leadership serves as a strategic resource, innovation capability functions as the dynamic capability that transforms leadership potential into tangible performance outcomes. In other words, leadership alone may not be sufficient to achieve superior performance unless it is translated into organizational capabilities that support innovation and adaptation. Through entrepreneurial leadership, SMEs become more capable of identifying opportunities, generating innovative ideas, and implementing strategic changes that ultimately improve organizational performance.

The significant direct and indirect effects indicate that innovation capability acts as a partial mediator. This means that entrepreneurial leadership continues to exert a direct influence on SME performance while simultaneously enhancing performance through innovation capability. The finding of partial mediation suggests that entrepreneurial leadership influences SME performance through multiple pathways. While innovation capability represents one important mechanism, entrepreneurial leadership also contributes directly to performance through strategic decision-making, opportunity exploitation, resource mobilization, and organizational direction.

This result is consistent with Taleb et al. (2023), who found that innovation capability mediates the relationship between entrepreneurial resources and business performance. The findings also support Jundulloh and Nasution (2024), who reported that innovation capability acts as an important pathway through which entrepreneurial leadership contributes to sustainable organizational performance. Furthermore, Annur et al. (2025) demonstrated that innovation capability mediates the relationship between entrepreneurial leadership and MSME performance in Indonesia, reinforcing the importance of innovation as a strategic mechanism for achieving competitive advantage.

Overall, this study contributes to the entrepreneurship and SME literature by providing empirical evidence from the Indonesian context, particularly among SMEs in Makassar City. The findings confirm the importance of entrepreneurial leadership as a strategic organizational resource and innovation capability as a dynamic capability that enhances organizational performance. Furthermore, this study extends previous research by demonstrating the mediating role of innovation capability in the relationship between entrepreneurial leadership and SME performance. The findings provide additional support for the integration of Resource-Based View and Dynamic Capability Theory in explaining how entrepreneurial leadership contributes to superior SME performance through the development of innovation capability.

Conclusion

This study examined the effect of entrepreneurial leadership on SME performance through the mediating role of innovation capability among SMEs in Makassar City, Indonesia. The findings demonstrate that entrepreneurial leadership plays a critical role in enhancing both innovation capability and SME performance. SME owners and managers who exhibit entrepreneurial

leadership characteristics, including opportunity recognition, proactiveness, risk-taking, and visionary behavior, are more capable of fostering innovation and improving organizational performance. The results further confirm that innovation capability significantly contributes to SME performance and serves as an important mechanism through which entrepreneurial leadership generates superior business outcomes. The significant direct and indirect effects found in this study indicate that innovation capability functions as a partial mediator, suggesting that entrepreneurial leadership improves SME performance both directly and through the development of organizational innovation capability. These findings provide empirical support for the Resource-Based View and Dynamic Capability Theory by highlighting entrepreneurial leadership as a strategic organizational resource and innovation capability as a dynamic capability that transforms leadership potential into sustainable performance advantages. Furthermore, this study contributes to the entrepreneurship and SME literature by providing empirical evidence from the Indonesian context, particularly among SMEs in Makassar City, where studies examining the mediating role of innovation capability remain relatively limited. The findings have important practical and academic implications. For SME owners and managers, the results emphasize the need to strengthen entrepreneurial leadership practices that encourage innovation, adaptability, and proactive opportunity exploitation. SMEs should continuously invest in product development, process improvement, and organizational learning activities to enhance their innovation capability and long-term competitiveness. For policymakers and SME support institutions, training and development programs focusing on entrepreneurial leadership competencies and innovation management should be expanded to strengthen the competitiveness and sustainability of SMEs. From an academic perspective, future studies are encouraged to extend the research model by incorporating additional variables such as entrepreneurial orientation, digital capability, market orientation, business resilience, or environmental dynamism to provide a more comprehensive understanding of SME performance. Future research may also involve larger sample sizes, different industrial sectors, and broader geographical areas to improve the generalizability of the findings.

References

- Ahmed, F., & Harrison, C. (2025). Entrepreneurial leadership development in teams: A conceptual model. *The International Journal of Entrepreneurship and Innovation*, 26(4), 267-279.
- Akbari, M., Bagheri, A., Imani, S., & Asadnezhad, M. (2021). Does entrepreneurial leadership encourage innovation work behavior? The mediating role of creative self-efficacy and support for innovation. *European Journal of Innovation Management*, 24(1), 1–22. <https://doi.org/10.1108/EJIM-10-2019-0283>
- Al-Sharif, A. M., Ali, M. H., Jaharuddin, N. S., Abdulsamad, A., & Jandab, A. (2023). The role of innovation capability in the relationship between entrepreneurial leadership and innovation performance in the SMEs service industry. *Advances in Social Sciences Research Journal*, 10(1), 264-278.
- Annur, A., Wartini, S., Martono, S., & Soliha, E. (2025). The role of innovation capability in the relationship between social capital, entrepreneurial leadership and MSME performance in Semarang's culinary sector. *Management Analysis Journal*, 14(2), 150–159. <https://doi.org/10.15294/maj.v14i2.26478>
- Arif, M. E. (2025). Synergizing entrepreneurial ecosystem, entrepreneurial leadership, and dynamic capability for creative SME performance in East Java. *Journal of Development*

- Ataei, P., Karimi, H., & Zarei, R. (2024). The role of entrepreneurial leadership, intellectual capital, innovativeness culture, and entrepreneurial orientation in entrepreneurial opportunity recognition by students. *Journal of Open Innovation: Technology, Market, and Complexity*, 10(2), 100265. <https://doi.org/10.1016/j.joitmc.2024.100265>
- Chandranathan, P. (2025). Entrepreneurial leadership and transformational leadership: a historical-comparative conceptual analysis. *Journal of management history*, 31(4), 592-609.
- Faul, F., Erdfelder, E., Buchner, A., & Lang, A.-G. (2009). Statistical power analyses using G*Power 3.1: Tests for correlation and regression analyses. *Behavior Research Methods*, 41(4), 1149–1160. <https://doi.org/10.3758/BRM.41.4.1149>
- Hair, J. F., Hult, G. T. M., Ringle, C. M., & Sarstedt, M. (2022). *A primer on partial least squares structural equation modeling (PLS-SEM)* (3rd ed.). Sage Publications.
- Haryono, F. R. Z., Sihombing, A. M., Prabawati, I., & Suprpto, F. A. (2026). MSMEs as a Driving Motor for Decent Work Towards a Sustainable Indonesian Economy. *Income Journal Of Economics Development*, 6(1), 89-96. <https://doi.org/10.54065/ijed.6.1.2026.743>
- Hasyim, H., & Bakri, M. (2025). Micro entrepreneur capacity building through financial management and marketing strategy training for MSME actors. *Celebes Journal of Community Services*, 4(1), 1-17.
- Hermansyah, H., Suhud, U., & Rizan, M. (2025). Empowering MSMEs in the digital era: A systematic literature review on the role of digital literacy. *Greenation International Journal of Economics and Accounting*, 3(2), 185-196. <https://doi.org/10.38035/gijea.v3i2.385>
- Hoang, G., Luu, T. T., & Babalola, M. T. (2025). Entrepreneurial leadership: A systematic literature review and research agenda. *Leadership & Organization Development Journal*, 46(2), 285-313. <https://doi.org/10.1108/LODJ-05-2024-0350>
- Ibrahim, A., Al-refaei, A. A. A., Alshuhumi, S., Al-Hidabi, D., & Ateeq, A. (2024). The effect of entrepreneurial leadership on employee's creativity and sustainable innovation performance in education sector: a literature review. *Business Development via AI and Digitalization: Volume 2*, 143-154. https://doi.org/10.1007/978-3-031-62106-2_12
- Jundulloh, R., & Nasution, Y. (2024). The influence of entrepreneurial leadership, entrepreneurship competence on sustainable organizational performance: The mediation role of innovation capability in MSME. *Tazkia Islamic Finance and Business Review*, 18(2), 158–192. <https://doi.org/10.30993/tifbr.v18i2.388>
- Khan, M., Rathore, K., Zubair, S. S., Mukaram, A., & Selem, K. M. (2024). Encouraging SMEs performance through entrepreneurial intentions, competencies, and leadership: Serial mediation model. *European Business Review*. Advance online publication. <https://doi.org/10.1108/EBR-04-2023-0119>
- Mahfud, I. (2025). The role of MSMEs (Micro, Small and Medium Enterprises) in improving the national economy. *Journal of Economics and Business Letters*, 5(5), 13-23. <https://doi.org/10.55942/jebll.v5i5.915>

- Martinravi, C. P., & Krishnasamy, K. (2025). Unleashing the potential of MSMEs in India: A strategic analysis. *Journal of the International Council for Small Business*, 6(1), 123-143. <https://doi.org/10.1080/26437015.2024.2397664>
- Mesut, C. (2026). Competitive Advantage Through Strategic. *Bridging Traditional Theory and Emerging Corporate Strategies*, 111.
- Murtini, M., Safii, A. A., & Anom, L. (2024). Exploring the relationship between entrepreneurial networking, entrepreneurial leadership, innovation capability, and MSMEs performance. *Innovation Business Management and Accounting Journal*, 3(1), 37–47. <https://doi.org/10.56070/ibmaj.2024.005>
- Nguyen, P. V., Huynh, H. T. N., Lam, L. N. H., Le, T. B., & Nguyen, N. H. X. (2021). The impact of entrepreneurial leadership on SMEs' performance: The mediating effects of organizational factors. *Heliyon*, 7(6), e07326. <https://doi.org/10.1016/j.heliyon.2021.e07326>
- Obeng, H. A., Arhinful, R., Mensah, L., & Mensah, C. C. (2025). The mediating role of service quality in the relationship between corporate social responsibility and sustainable competitive advantages in an emerging economy. *Business strategy & development*, 8(1), e70099. <https://doi.org/10.1002/bsd2.70099>
- Otache, I., & Onuh, T. A. (2026). Impact of entrepreneurial leadership on institutional competitiveness and performance in HEIs: the mediating role of entrepreneurial culture. *African Journal of Economic and Management Studies*, 1-15. <https://doi.org/10.1108/AJEMS-02-2025-0107>
- Purwati, A. A., Budiyo, B., Suhermin, S., & Hamzah, M. L. (2021). The effect of innovation capability on business performance: The role of social capital and entrepreneurial leadership on SMEs in Indonesia. *Accounting*, 7(2), 323–330. <https://doi.org/10.5267/j.ac.2020.11.021>
- Razzaque, A., Lee, I., & Mangalaraj, G. (2024). The effect of entrepreneurial leadership traits on corporate sustainable development and firm performance: a resource-based view. *European Business Review*, 36(2), 177-200. <https://doi.org/10.1108/EBR-03-2023-0076>
- Renko, M., El Tarabishy, A., Carsrud, A. L., & Brännback, M. (2015). Understanding and measuring entrepreneurial leadership style. *Journal of Small Business Management*, 53(1), 54–74. <https://doi.org/10.1111/jsbm.12086>
- Sai, C., Omar, A. R. C., Hizam-Hanafiah, M., & Juhdi, N. (2024). The effect of entrepreneurial leadership on innovation performance in SMEs: A systematic literature review. *Journal of Ecohumanism*, 3(8), 3284–3296. <https://doi.org/10.62754/joe.v3i8.4970>
- Satar, A., Musadieq, M. A., Hutahayan, B., & Solimun, S. (2025). Creating a sustainable competitive advantage: the roles of technological innovation, knowledge management, and organizational agility. *Global Business and Organizational Excellence*, 44(3), 11-23. <https://doi.org/10.1002/joe.22280>
- Sawaeen, F. A. A., & Ali, K. A. M. (2020). The impact of entrepreneurial leadership and learning orientation on organizational performance of SMEs: The mediating role of innovation capability. *Management Science Letters*, 10(16), 3691–3700. <https://doi.org/10.5267/j.msl.2020.6.033>

- Shiferaw, R. M., Birbirs, Z. A., & Werke, S. Z. (2023). Entrepreneurial leadership, learning organization and organizational culture relationship: A systematic literature review. *Journal of Innovation and Entrepreneurship*, 12(1), 38. <https://doi.org/10.1186/s13731-023-00305-z>
- Simanjuntak, R. H., & Pasaribu, M. (2023). The influence of entrepreneurial leadership, dynamic capability, innovation, and digitalization on the performance of MSMEs. *Al-Qalam: Jurnal Kajian Islam dan Pendidikan*, 17(4). <http://dx.doi.org/10.35931/aq.v17i4.2330>
- Taleb, T. S. T., Hashim, N., & Zakaria, N. (2023). Mediating effect of innovation capability between entrepreneurial resources and micro business performance. *The Bottom Line*, 36(1), 77–96. <https://doi.org/10.1108/BL-07-2022-0093>
- Umamy, S. H., & Nuha, G. A. (2025). The role of entrepreneurial leadership and competence in enhancing MSME performance: A case study in Jember Regency. *Widyacipta: Jurnal Sekretari dan Manajemen*, 9(2). <https://doi.org/10.31294/widyacipta.v9i2.11523>
- Wang, S., Gao, M., & Zhang, H. (2025). Enhancing creativity and sustainable competitive advantage through data-driven decision-making and digital leadership. *IEEE Transactions on Engineering Management*, 72, 1361-1375. <https://doi.org/10.1109/TEM.2025.3551331>
- Zainuri, Z., Yasin, M. Z., Amijaya, R. N. F., Wilantari, R. N., & Vipindrartin, S. (2025). The role of government policy on the performance of MSMEs in the creative industry: evidence from Jember Regency, East Java, Indonesia. *Cogent Economics & Finance*, 13(1), 2446657. <https://doi.org/10.1080/23322039.2024.2446657>