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Innovation As A Catalyst: Mediating The Impact Of Entrepreneurial Leadership On Performance In Nepali Small And Medium Enterprises

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Abstract
This study examined how Entrepreneurial Leadership would affect the performance of a firm and the effect the presence of innovation within the firm could have on the relationship in case of Nepali SMEs. The survey used responses from 289 Owners and Managers of Small and Medium Enterprises (SME) in Nepal. The analysis used EFA (Exploratory Factor Analysis) to establish/affirm factor structure, model fit, validity and reliability testing was done using CFA (Confirmatory Factor Analysis) while SEM (Structural Equation Modeling) was used to test and validate relationships. The study found that higher levels of entrepreneurial leadership within a firm had a positive effect on its overall performance. The study also found that partial mediation occurred in the relationship between entrepreneurial leadership and firm performance through innovation. This showed that an organization's ability to increase entrepreneurial leadership would have a substantial bearing on its ability to perform. The study also showed that development of entrepreneurial leadership and support for innovation needed to be carried out in parallel as the partially mediating effect suggested that entrepreneurial leadership leads to firms' performance not only through innovation through other mechanisms as well. This underlined the need for owners and managers within SMEs to become more entrepreneurial while also continuing to develop their leadership abilities and promoting innovation within their organizations to help them perform better.
Keywords: *Entrepreneurial Leadership, Innovation, Firm Performance, SMEs, Mediation Analysis, Nepal*

INTRODUCTION

The need and impact of entrepreneurial leadership is often felt most in the case of evolving business environments that cannot offer stability and certainty, such as Nepal. The ability of leaders to plan strategically, manage risks, and spot market opportunities early is quite important for markets that are not only of a dynamic nature but also highly turbulent. Recent academic studies have shown that entrepreneurial leaders foster creativity in the workplace and support the growth of problem-solving skills in employees. As research by Khalil et al. (2022) indicates, team-based creativity and innovative actions this form of leadership facilitates. Similarly, it has also been observed that supportive managerial actions lead to increases in employee innovation skills, which in turn result in higher performance (Akbari et al., 2021). Similarly, entrepreneurial leadership has been shown to enable leaders to successfully work in unknown business terrains due to their innate ability to maneuver their teams and adapt to ever-changing circumstances (Renko et al., 2013). Despite the acknowledgement of the relevance of Entrepreneurial Leadership for businesses in the developing economy, such as Nepal, the specific mechanisms on how Entrepreneurial Leadership influences business outcomes in Nepal's context are not well understood. Extant studies have emphasized the direct association between leadership styles and performance variables, but with less attention to possible mediating mechanisms. Moreover, although linkages have been established between the presence of entrepreneurial leadership in firms and their business performance, the studies on them spanning different emerging markets while adding value to the discourse nevertheless still fail to address the specificities of the Nepali business context, such as political transitions, geographical constraints, and accelerated urbanization, which could modify such associations in a significant manner. Given the scant extant empirical work on Nepalese small businesses, this provides a chance to investigate not only whether entrepreneurial leadership matters, but exactly how it can influence performance through innovation routes within this specific context.

Thus, in this study, we are trying to investigate how entrepreneurial leadership practices influence business performance and whether innovation plays a role in mediating this relationship. In doing so, we also conform to the idea that entrepreneurial leadership affects firm performance and further assert that the impact is intensified in innovation-enhancing climates.

LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

Entrepreneurial leadership combines the opportunity-centered nature of entrepreneurs with essential leadership qualities. This leadership style is particularly valuable in SMEs where organizational adaptability and resource constraints require leaders to engage in both strategic planning and innovation. Entrepreneurial Leaders tend to take actions that allow their firms to accurately detect and act on potential opportunities, especially in uncertain circumstances (Renko et al., 2015). Leaders practicing this style motivate teams, enable risk-taking, and foster innovation—all crucial drivers of firm performance in uncertain conditions (Liu et al., 2022).

1.1Entrepreneurial Leadership and SME Performance

Entrepreneurial leadership directly affects organizational effectiveness by enabling companies to dynamically utilize internal resources such as innovation and adaptability. Mehmood et al. (2021) demonstrated that entrepreneurial leadership facilitates team creativity and responsiveness, which are critical for competitive advantage. Yang and Bentein (2023) found that entrepreneurial self-efficacy, facilitated by leadership, influences employee creativity and innovation-driven performance. Innovation orientation and opportunity-seeking behaviors positively affect firm performance (Razzaque et al., 2023; Barati, 2024).An important dimension of entrepreneurial leadership, transformational leadership helps in improving engagement of employees and in turn supports more effective decision making within the organization (Veiseh et al., 2014; Ghaleb, 2024). Ojokuku et al. (2012) found that leadership style explains a substantial portion of firm performance variance. Sitompul et al. (2019) demonstrated that transformational leadership impacts organizational commitment. Employee empowerment and support for creativity indirectly support the mediation effect of innovation on performance. (Avolio et al., 2004; Mangundjaya, 2019).

1.2Innovation as a Strategic Resource

According to Schumpeter, innovation plays a rather important role in supporting economic advancement and helps firms secure a good competitive edge. For SMEs, innovation can help them overcome resource limitations, adapt to market changes, and exploit new opportunities. Fatmah et al. (2024) concluded that product innovation impacts market positioning, particularly in fast-moving markets. O'Cass and Weerawardena (2009) found that innovation capability was enabling smaller firms to successfully penetrate international markets and thus enhancing financial performance. Tantai et al (2024) stressed the role of innovation in linking smaller firms to external knowledge reservoirs. From a resource-based perspective, innovation represents a strategic capability. Entrepreneurial leaders align organizational resources with innovative efforts. Liu et al. (2018) demonstrated that leadership enhances employee innovation and facilitates effective human capital utilization. Hu et al. (2022) noted that leadership-influenced management team capabilities are crucial for strategic success.

1.3Innovation as a Mediator

While there is ample evidence of a direct association between entrepreneurial leadership and firm performance, recent evidence indicates that innovation acts as an important mediator in the reinforcement of this relationship. Entrepreneurial orientation has often been linked to the encouragement of innovation, which results in positive organizational outcomes. For example, entrepreneurial leaders are found to foster environments supporting innovative thinking, resulting in more successful business outcomes (Bagheri et al., 2022). Likewise, companies that focused on promoting innovation and increasing team autonomy noticed remarkable changes in their performance (Hinteregger et al., 2019).This is even more relevant in resource-scarce settings, where entrepreneurial bricolage is crucial. In such environments, for firms, bricolage, the process of creating new combinations of constrained resources to achieve new opportunities, is an important way of operating. Zhang et al. (2021), transformational leadership promotes bricolage actions, resulting in improved performance of the company. Also, the combination of innovation and market knowledge has been demonstrated to

enhance international competitiveness (Falahat et al., 2020).Recent reports have also focused on the growing relevance of digital innovation for SME development. Solaja et al. (2025) noted that becoming a digital innovator is no longer an option but a requirement for growth. Equally important is to implant an innovation-oriented culture in an organization, which is the basis for successful implementation of strategy and long-term success (Wolf et al., 2012).Consequently, the study looks towards evaluating the following hypotheses:

H1: Entrepreneurial leadership has a significant positive effect on firm performance in Nepali SMEs.

H2: Innovation mediates the relationship between entrepreneurial leadership and firm performance in Nepali SMEs.

2 METHODOLOGY

2.1 Research Design

This study used various tools and techniques to examine the correlations among Innovation, Entrepreneurial Leadership, and Firm Performance within organizational settings. A total of 310 participants were selected from a diverse range of industries, encompassing SME owners and managers, ensuring a wide spectrum of organizational insights and perspectives. A structured 15-item questionnaire, with 5 items per construct was used to gather data on entrepreneurial leadership (independent variable), innovation (mediating variable), and firm performance (dependent variable) using a five-point Likert scale (Strongly Disagree to Strongly Agree). After the data quality check, 289 valid data sets were found to be valid for analysis.The entrepreneurial leadership construct was operationalized using the themes from Renko et al. (2015), namely assessing how entrepreneurs exhibit strategic risk, innovation forwardness, creative problem solving, and team motivation towards innovation behaviors. Our innovation construct, derived from Murniningsih and Hanafi (2020), was characterized by the organization's potential to generate innovative ideas, implement creative solutions, allocate resources for innovation, and the extent to which firms differentiated themselves in the market by making pioneering product or service introductions. This construct was conceptualized based on the items suggested by Bontis (1998), which assessed firm performance from various stakeholder perspectives (revenue growth, human capital receipt, market standing, profitability) compared to industry rivals.Using structural equation modelling, we evaluated the hypotheses regarding both direct and indirect effects among study variables.

Table 1- Variables and Survey Questions

Variable	Survey Questions
Innovation	Our company continually explores innovative approaches to conducting business.
	We often introduce new products or services ahead of our competitors.
	Adequate funding is allocated to support the development of new products or services.
	We are considered an industry leader in terms of innovation and pioneering practices.
	Our senior leadership actively promotes and supports innovation-related efforts.
Entrepreneurial Leadership	Management frequently pushes for transformative improvements to our existing products or services.
	The manager regularly suggests entirely new products or services that could be introduced onto the market.

Variable	Survey Questions
	The manager is willing to take bold actions and calculated risks.
	Managers show strong enthusiasm and commitment to their work.
	Manager Motivates and encourages team members to think and act innovatively.
Firm Performance	Compared to our competitors, our company has demonstrated sturdy growth in sales.
	Our organization has seen a steady increase in employment over recent years.
	We maintain or expand our market share more effectively than our key competitors.
	Our gross profit levels are consistently strong in comparison to other firms in the industry.
	Our net profit margins are healthy and competitive within our sector.

2.2Data Analysis

We conducted our analysis using specialized statistical analysis software (SPSS and AMOS) in sequential steps. First, EFA was performed to discover the patterns that exist between constructs. Then, the reliability, validity, and goodness of fit of the determined constructs were evaluated by the Measurement Model and Structural Model using Confirmatory Factor Analysis (CFA). Following the two-step process proposed by Anderson & Gerbing (1988), to conduct goodness of fit testing, reliability and validity testing, and hypothesis testing.To ascertain the fit of the proposed model, various indicators such as chi-square (x2), chi square to degree of freedom ratio (x2/df), Tucker-Lewis Index (TLI), Comparative Fit Index (CFI), Root Mean Square Error of Approximation (RMSEA), and Standardized Root Mean Squared Residual (SRMR) were used.Principal Component Analysis with Varimax Rotation was used during Exploratory Factor Analysis. The analysis established a factor loading threshold of 0.70 (Hair Jr. et al., 2019); also, scale communalities were considered for adequate variance explanation. All communality values exceeded the recommended 0.50 minimum threshold. The dataset set was confirmed to be fit for factor analysis by the significance of the correlation matrix with statistically significant results (χ^2 (66) = 2122.775, $p < 0.001$) for Bartlett's Test of Sphericity and a Kaiser-Meyer-Olkin (KMO) measure of sampling adequacy of 0.882, exceeding the minimum requirement of 0.80 and further validating the data's suitability for factor analysis. Three factors were extracted in our analysis, accounting for 72.77% of the total variance. The rotated component matrix showed high item loadings onto their designated theoretical constructs: Entrepreneurial Leadership (EL), Innovation (INV), and Firm Performance (FP).

Table 2-KMO and Bartlett's Test

Kaiser-Meyer-Olkin Measure of Sampling Adequacy.		.882
Bartlett's Test of Sphericity	Approx. Chi-Square	2122.775
	df	66
	Sig.	.000

Table 3-Rotated Component Matrix

	Component		
	EL	**INV**	**FP**
EL1	.894		
EL3	.858		
EL4	.820		
EL5	.861		
INV1		.778	
INV2		.787	
INV3		.762	
INV4		.775	
FP2			.753
FP3			.752
FP4			.744
FP5			.758

Internal reliability was evaluated, giving alpha coefficients between 0.840 and 0.904, which were all above the cutoff value of 0.7. Items such as EL2, INV5, and FP1 were removed for factor loadings<0.7.

Measurement Model Evaluation

Confirmatory Factor Analysis (CFA) was conducted to evaluate the measurement model for model fit, convergent validity, discriminant validity, and construct reliability by incorporating the three latent constructs: Entrepreneurial Leadership (EL), Innovation (INV), and Firm Performance (FP).

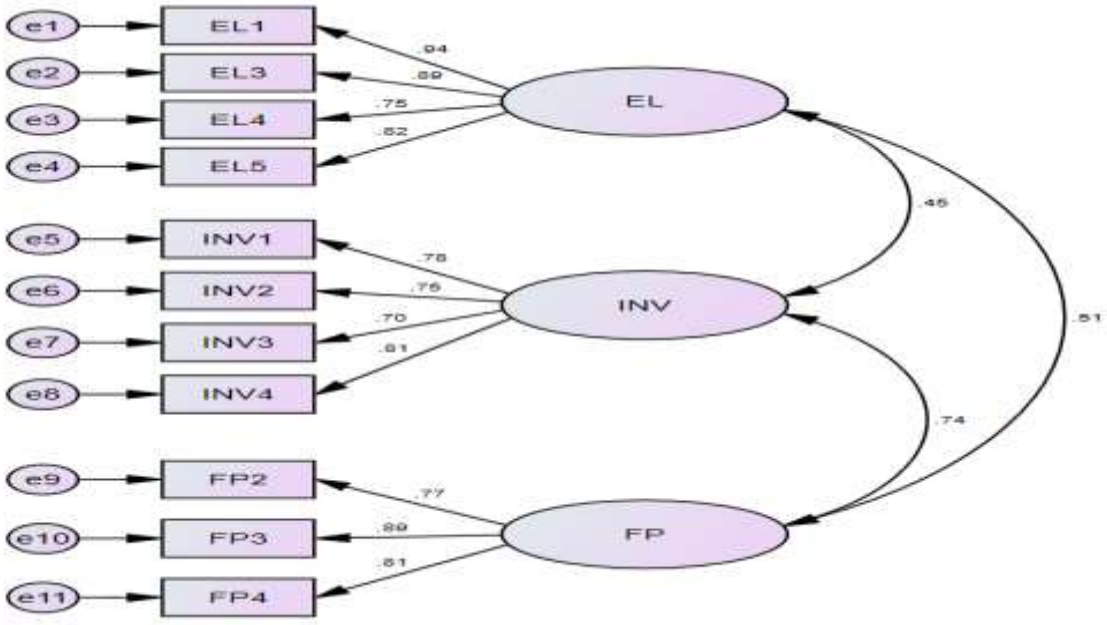

Figure 1-Measurement Model

Looking at the fit indices, the measurement model showed an acceptable fit for the data with x2/df equal to 1.598, CFI equal to 0.988, TLI equal to 0.983, SRMR equal to 0.027, RMSEA equal to 0.046, and Pclose equal to 0.617, all crossing the recommended thresholds for adequacy of fit (Hu & Bentler, 1998). FP5 was removed from the measurement model during CFA as its standardized factor loading onto its construct was below the acceptable threshold of 0.7.

Table 4-Goodness of Fit Indices (Measurement Model)

Measure	Estimate	Threshold
X2/DF	1.598	Between 1 and 3
CFI	0.988	>0.95
TLI	0.983	>0.95
SRMR	0.027	<0.08
RMSEA	0.046	<0.06
PClose	0.617	>0.05

For construct validity, the reported values of Composite Reliability (CR) (0.847-0.916, all above the criteria of 0.70) (Sideridis et al., 2018) and Average Variance Extracted (AVE) (0.582-0.732, more than the minimum of 0.50) (Bagozzi & Yi, 1988) validated the same. The discriminant validity was supported based on accepted guidelines, where the square root of AVE values was greater than inter-construct correlations, Fornell-Larcker (1981), and AVE for each construct exceeded its Maximum Shared Variance (MSV).

Table 5-Reliability and Validity Assessment

Construct	EL	INV	FP
CR	0.916	0.847	0.866
AVE	0.732	0.582	0.683
MSV	0.26	0.548	0.548
MaxR(H)	0.94	0.852	0.878
EL	0.856	0.451***	0.510***
INV		0.763	0.741***
FP			0.827

Structural Model Evaluation

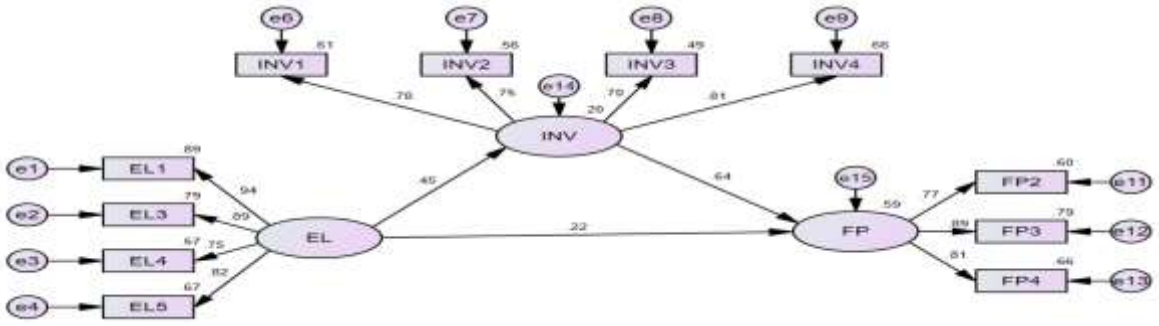

Figure 2-Structural Model

Looking at the fit indices, the structural model showed an acceptable fit for the data with x2/df equal to 1.598, CFI equal to 0.988, TLI equal to 0.983, SRMR equal to 0.027, RMSEA equal to 0.046, and Pclose equal to 0.617, all crossing the recommended thresholds for adequacy of fit (Hu & Bentler, 1998).

Table 6-Goodness of Fit Indices (Structural Model)

Measure	Estimate	Threshold
X2/DF	1.598	Between 1 and 3
CFI	0.988	>0.95
TLI	0.983	>0.95
SRMR	0.027	<0.08
RMSEA	0.046	<0.06
PClose	0.617	>0.05

The direct influence of Entrepreneurial Leadership (EL) on Firm Performance (FP) was evaluated to verify the first hypothesis (H1). The findings established a significant positive association (Standardized β= 0.221, p= 0.000), which shows that entrepreneurial leadership directly contributes to firm performance in SMEs in Nepal.

Table 7-Hypothesis Testing (Direct Effect)

Hypothesis	H1: EL significantly impacts FP.
Path	EL → FP
Standardized Estimate (β)	0.221
Unstandardized Estimate	0.164
SE	0.042
CR	3.894
p-value	0.000
Decision	Supported

To examine the second hypothesis (H2), the mediating role of innovation was evaluated using bootstrapping techniques (5,000 resamples, 95% confidence intervals). The results showed a significant positive indirect impact (Estimate = 0.214, 95% CI [0.131, 0.321], p<0.001). With the direct and mediated effects of Entrepreneurial Leadership, with both direct and indirect paths achieving significance, it has also been shown that there is a partial mediation brought forth by innovation in the relationship between Entrepreneurial Leadership and Firm Performance.

Table 8-Mediation Analysis

Hypothesis	H2: INV mediates the relationship between EL and FP
Path	EL → INV → FP
Direct Effect	0.164 (0.00)
Indirect Effect	0.214
Lower Bound (95% CI)	0.131
Upper Bound (95% CI)	0.321

Significance (p-value)	0.000
Decision	Partial Mediation Supported

CONCLUSION

The results of the study show that the entrepreneurial leadership plays a significant role in improving performance among Nepali SMEs. The results also confirm a partially mediating role of innovation in this relationship show that other factors along with innovation may empower leadership to turn to performance. These results bear resemblance to the findings of Nguyen et.al (2021), which showed that entrepreneurial leadership exerts an effect on the organizational orientation and reinforces a group of abilities: proactive market engagement and risk management which showed a direct and positive impact on firm performance and outcomes. The findings of this study concur with studies that show firms that are led by entrepreneurial managers are better positioned to achieve success as they can more effectively manage market uncertainties, exploit innovative opportunities, consequently leading to a more sustainable path for growth. (Akbari et al., 2021; Mehmood et al., 2021).The verified partial mediation of innovative capability explains how leadership characteristics lead to performance outcomes, consistent with the results of (Bagheri et al., 2022) and (Shofi and Conceica, 2024) study findings, where entrepreneurial leaders supported workplace innovation through the mechanism of stimulating creative thinking, supporting autonomy, and promoting experimentation. The findings also align with both the resource-based view and dynamic capabilities view, suggesting that competitive advantage comes from not only the leadership behaviors but also from how leaders develop the organizational innovation ecosystem (Abiyasa & Utama, 2023).The mediating effect indicates that entrepreneurial leadership generates compounding effects on organizational performance from the innovation as core competence instead of the innovation as a fringe activity. This supports findings by Ercantan et al. (2024) and Huang et al. (2014) who concluded that a supportive innovation environment and environmental dynamism enhance the effectiveness of innovation-driven leadership.Theoretically, our study also confirms innovation as an important mediating process by which leadership practices can be explained for their effects on organizational outcomes in the context of the developing country small-business environment. It complements current models by anchoring theoretical relations in Nepali enterprises, in which R&D activities are frequently resource-constrained and bear little support from organizations. The results are consistent with classical views of innovation as a primary determinant of entrepreneurial success and long-term competitive advantage (Schumpeter, 1942).These insights can be especially important for SME stakeholders in developing countries such as Nepal, as they underline the strategic imperative of building an entrepreneurial leadership mindset on top of solid innovation systems. Through the cultivation of transformational leaders who foster innovation and organizations can become more resilient in changing markets, have operational flexibility, and a competitive advantage for Nepali small businesses in the local and global markets.The study also highlights the importance of making equal investments for promoting entrepreneurial leadership development and innovation systems. Similarly, leadership of the organization will need to become skillful not only in strategic planning, but in stimulating team creativity and entrepreneurial activity as shown in the works of Hikmat et al. (2024) which showed that firms that emphasize leadership development and innovation infrastructure are more likely to exhibit higher operational excellence and market resilience in a competitive setting.Future research possibilities include examining other mediating variables, such as organizational learning culture, degree of digital transformation readiness, or environmental dynamism. Longitudinal investigations can yield closer insights into causal relationships and the temporal dynamics. Sector sector-wise study on manufacturing, service, and agriculture-based small businesses may provide a rich contribution in understanding context-specific effects on leadership-innovation-performance relationships. Thus, Firms should emphasize leadership programs focused on opportunity identification, risk-taking, and innovation. At the same time, the creation of enabling innovation infrastructures such as resource allocation mechanisms, platforms for sharing knowledge, and mechanisms for recognition may help to optimize the effectiveness of leadership by fostering environments where innovative thinking can flourish at any level in the organizational hierarchy.

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