Driving SME Performance through Absorptive Capacity: An Empirical Analysis

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Abstract: *Absorptive capacity, the ability of firms to acquire and utilise external knowledge, is essential for enhancing performance in small and medium enterprises (SMEs). Despite its importance, empirical studies focusing on this relationship within the SME context are scarce. This research addresses this gap by investigating how absorptive capacity influences SME performance, specifically examining the dimensions of knowledge acquisition, assimilation, and applying. Data was collected from 206 managers and owners of SMEs in the Manzini region using a self-administered questionnaire, employing a cross-sectional design. The analysis utilised Pearson's correlation coefficient to test the proposed hypotheses. The findings reveal a significant positive correlation between absorptive capacity and SME performance, with knowledge transformation and application identified as the most impactful dimensions. This study contributes to the literature by providing empirical evidence of the critical role of absorptive capacity in driving SME performance. It emphasises the need for SMEs to invest in knowledge management and collaborative practices to enhance their absorptive capacity. The results also offer practical implications for policymakers to create supportive environments that foster knowledge exchange and innovation, ultimately aiding in the growth and competitiveness of SMEs.*

Keywords: *Acquisition, Application, Assimilation, Knowledge, SMEs*

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1. Introduction

Small and medium enterprises (SMEs) are widely recognised as a cornerstone of economic growth in developing countries, significantly contributing to national GDP through job creation (Irfan et al., 2014). However, despite their critical role, SMEs face numerous challenges that threaten their sustainability and often lead to failure. A major issue is the lack of adequate resources to invest in research and development (R&D), which limits their ability to innovate and remain competitive (Moilanen et al., 2014). This gap necessitates the adoption of environmental analysis practices, such as competitive intelligence (CI), to enhance their strategic capabilities and competitiveness (Guimaraes et al., 2016).

In today's highly competitive business environment, firms require robust knowledge resources to thrive (Sancho-Zamora et al., 2021). Absorptive capacity (AC), defined by Cohen and Levinthal (1990) as "the ability to acquire, assimilate, and exploit external information for commercial ends," is a critical capability for organisations aiming to improve their performance. Beyond enhancing an organisation's existing knowledge base, AC fosters the creation of new knowledge, which is essential for entrepreneurial success (Patel et al., 2012, as cited in Sancho-Zamora et al., 2021). This success often depends on a firm's ability to renew its products and strategic technologies, enabling it to operate more efficiently and reduce costs (Sancho-Zamora et al., 2021). While the concept of AC has been extensively studied, evidence of its direct link to organisational performance in SMEs remains underexplored (Ismael et al. 2025)

Although theoretical models have outlined the antecedents and consequences of AC, there is limited

empirical evidence explaining its role in enhancing performance (Grimpe & Sofka, 2009, as cited in Kostopoulos et al., 2011). Liu et al. (2018) further emphasise that few studies have examined the practical applications and ultimate outcomes of adopting AC to improve organisational performance. From a capabilities perspective, AC has been shown to significantly impact performance. Research by Tzokas et al. (2015) highlights the connection between AC's antecedents and a firm's performance (Liu et al., 2018). Specifically, studies have established a strong relationship between AC and the business performance of SMEs (Arshad & Arshad, 2019).

Moreover, AC plays a crucial role in fostering innovation capabilities, which are often linked to improved business performance (Oliveira et al., 2020). However, conflicting findings exist, as some studies suggest that innovation capability does not always lead to better performance (Tresna & Raharja, 2019). These discrepancies, likely influenced by variations in SME characteristics, underscore the need for further investigation into the role of AC in driving SME performance. This article aims to address this gap by exploring how absorptive capacity can be leveraged to enhance the performance of SMEs, particularly in the context of developing economies.

While prior studies have highlighted the potential of absorptive capacity (AC) to enhance organisational performance and innovation capabilities, significant gaps remain in the empirical understanding of its practical applications and outcomes (Omar, et al. 2023). To address these gaps, the following hypotheses were formulated to empirically examine the role of absorptive capacity in driving SME performance.

The main hypothesis of the study was: There is no significant impact of absorptive capacity on the performance of SMEs in the Manzini region, Eswatini. To understand the impact of the dimensions of absorptive capacity on performance, the following specific hypotheses were formulated:

a) $Ho_{1a:}$ *Knowledge recognition has no significant impact on the performance of SMEs.*

b) $Ho_{1b:}$ *Assimilation has no significant impact on the performance of SMEs.*

c) $Ho_{1c:}$ *Application has no significant impact on the performance of SMEs.*

2. Literature Review

2.1 Absorptive Capacity

Absorptive capacity was first introduced by Cohen and Levinthal (1990) as a firm's ability to recognise the value of new external knowledge, assimilate it, and apply it to commercial ends. This definition emphasised the importance of external knowledge as a resource for innovation and competitive advantage. Over time, the concept has evolved to encompass four dimensions: knowledge acquisition, assimilation, transformation, and exploitation (Zahra & George, 2002). Absorptive capacity enhances the ability of companies to identify and integrate external knowledge throughout the innovation process (Chigu et al., 2018). It fortifies essential functional areas within the organisation (Gao et al., 2017) and is crucial for transforming external knowledge into innovative outcomes (Santos et al., 2015). Additionally, it enables companies to discover new business opportunities and develop strategies that help them stand out and build their brand reputation (Filipe & Moutinho, 2016).

Zahra and George (2002) categorised absorptive capacity (AC) into two components: potential absorptive capacity (PACAP), which includes knowledge acquisition and assimilation, and realized absorptive capacity (RACAP), which encompasses knowledge transformation and exploitation. This distinction emphasises the dynamic nature of AC, where PACAP focuses on the ability to acquire and understand external knowledge, while RACAP pertains to applying this knowledge for tangible outcomes. Although Zahra and George identified four dimensions of AC—acquisition, assimilation, transformation, and exploitation—Cohen and Levinthal's (1990) three dimensions (recognise, assimilate, and apply) remain widely accepted in research. PACAP involves identifying and acquiring external knowledge to enhance operations, while assimilation refers to the internal processes for analysing and interpreting this knowledge. RACAP emphasises the practical application of acquired knowledge to create value for both customers and organisations. Ultimately, the goal of acquiring and assimilating knowledge is to leverage it for commercial purposes, enabling firms to improve existing processes and innovate effectively. This practical approach allows organisations to utilize their resources collaboratively to enhance production operations and overall performance. Figure 1 below presents a mode of absorptive capacity. The aim is to present a revised model of absorptive capacity as presented by Zahra and George (2002, as cited in Abrell et al., 2018).
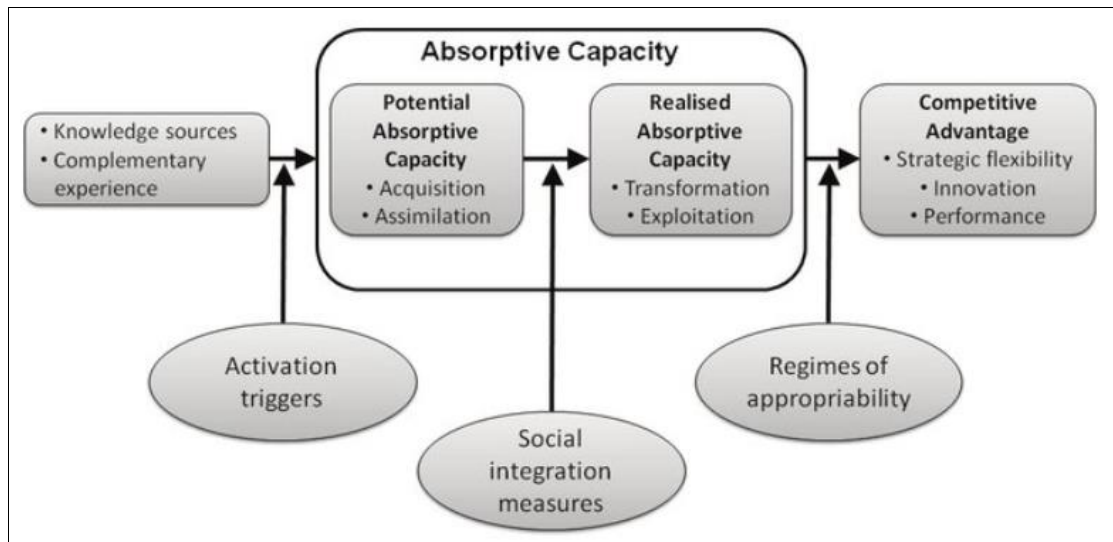
Figure 1: Elaboration of Zahra and George (2002) absorptive capacity model

Source: Abrell et al. (2018: p.11)

Zahra and George (2002) developed a comprehensive model of absorptive capacity (AC), introducing key components such as acquisition, assimilation, transformation, and exploitation, while categorising AC into potential and realized capacities. They replaced Cohen and Levinthal's (1990) "recognising value" with "acquisition" and introduced new elements like activation triggers and social integration mechanisms. These additions highlight the dynamic nature of AC, emphasising how firms adapt processes to integrate and apply new knowledge. Social integration mechanisms, for instance, reduce barriers between assimilation and transformation, enhancing knowledge flow, while activation triggers stimulate or restrict a firm's ability to utilize knowledge. Appropriability regimes, such as secrecy, were also identified as critical for securing competitive advantages. However, the model has limitations. While it expands AC conceptually, it remains largely theoretical, with limited empirical validation. It is still argued that there are relatively few empirical studies examining the factors that determine absorptive capacity, which highlights a gap in existing research (Audretsch et al., 2021). To address this gap, further empirical validation is needed.

2.1 SME Performance

The performance of small and medium enterprises (SMEs) has been a focal point in entrepreneurship research, often examined through models that predict success or failure. Ion and Criveanu (2016) trace the concept of performance to its origins in mechanics and sports, where it denoted achieving "good" results. They align with Porter (1981, as cited in Omar et al., 2005), viewing performance as an outcome-based concept tied to goal achievement. Goals, as highlighted by Etzioni (1960) and Jenatabadi (2015), provide direction and legitimacy to an organisation, serving as benchmarks for

measuring success. Lupton (1978, as cited in Stanciu et al., 2019) emphasise that effective organisations exhibit high productivity, satisfaction, and motivation, with minimal turnover or unrest. Historically, performance was measured through financial metrics like profitability and return on investment (ROI). However, Kaplan and Norton (1996) criticised this narrow focus, advocating for a balanced approach that integrates both financial and non-financial indicators.

Non-financial measures, such as innovation, customer satisfaction, and flexibility, reflect long-term objectives and future performance potential. While financial performance remains crucial, non-financial metrics address broader organisational goals. Ioniță (2013) raises a critical question about why some SME managers prioritise economic goals while others focus on non-economic ones, linking success to achieving purpose-driven outcomes.

3. Methodology

The study employed a positivist research philosophy, focusing on an objective reality while maintaining distance between the researcher and participants to reduce subjectivity (Saunders, 2011). A quantitative, deductive approach was utilised, featuring a cross-sectional survey design. Data was gathered via a self-administered questionnaire targeting SME owners/managers in Manzini, with 206 respondents participating in the study. Absorptive capacity was measured through knowledge recognition; assimilation and application while performance was measured through; customer satisfaction; innovation; efficiency; and productivity. Reliability was confirmed with Cronbach's Alpha scores above 0.6 (De Souza & Dick, 2009), and regression analysis explored the relationship between absorptive capacity dimensions and

performance of SMEs. Pearson's coefficients were used to determine the effect of each dimension of absorptive capacity on the performance of SMEs.

4. Results and Discussion

4.1 Hypotheses Testing

This section focuses on hypothesis testing, a crucial process that enables researchers to evaluate the relationships and differences suggested by the data, thereby providing a deeper understanding of the underlying patterns and trends. Building on the insights gained from the dataset, the following hypothesis was tested: **Ho1: There is no significant impact of absorptive capacity on the performance of SMEs in the Manzini region, Eswatini.** The dimensions of absorptive capacity examined include knowledge recognition, assimilation, and application. Table 1 presents the results of the structural equation modeling (SEM) analysis, which evaluates the relationship between absorptive capacity and SME performance. The results include standardized estimates, standard errors, z-values, p-values, and confidence intervals, providing robust evidence for hypothesis testing.

Table 1: Regression coefficients for absorptive capacity and performance.

| Variable | Estimate | Std. Error | z-value | P | 95% Confidence Interval | | Standardized | | |
					Lower	Upper	All	LV	Endo
AC	0.307	0.062	4.958	< .001	0.186	0.428	1.000	1.000	1.000

In Table 1, the z-value is 4.958. A z-value this large indicates that the estimate is far from zero in standard error units, providing strong evidence against the null hypothesis. The corresponding p-value is < .001, which is well below the conventional threshold of 0.05. Results in Table 1 reveal that the estimate of 0.307 shows that a one-unit change in absorptive capacity results in a 0.307 change in performance. The results in Table 1 show that the amount of variability is explained by the observed indicators, thus, pointing to the direction that the null hypothesis is not accepted. Bearing in mind the results from the analysis of data on hypothesis 1, the section below presents results (Pearson's correlation) of three dimensions that were used to measure absorptive capacity (knowledge recognition, assimilation, and application). Table 2 below presents results of the tests of the three sub-hypotheses; $Ho1_a$: Knowledge recognition has no significant impact on the performance of SMEs; $Ho1_b$: Assimilation has no significant impact on the performance of SMEs and $Ho1_c$: Application has no significant impact on the performance of SMEs.

Table 2: Impact of the Dimensions of Absorptive Capacity on Performance

Dimension	Pearson's Correlation (r)	Sign. (2 0-tailed)	N
Knowledge Recognition	0.494**	0.000	205
Assimilation	0.323**	0.000	206
Application	0.342**	0.000	205

The analysis of the correlation between the dimensions of absorptive capacity and performance of SMEs reveals insightful findings. For Knowledge Recognition, the Pearson correlation coefficient is 0.494, indicating a moderate positive correlation. This suggests that as the organisation's ability to recognise knowledge improves, performance tends to increase correspondingly. The significance value (Sig. (2-tailed)) is 0.000, which is less than 0.01, confirming that this correlation is statistically significant, and with a sample size of 205 participants, the results are robust and reliable. In contrast, the correlation for Assimilation and Performance is 0.323, reflecting a weak to moderate positive correlation. This implies that while the organisation's ability to integrate new knowledge into its processes positively impacts performance, the relationship is weaker compared to

Knowledge Recognition. The significance value remains at 0.000, indicating statistical significance, supported by a sample size of 206. Lastly, the correlation for Application and Performance is 0.342, also indicating a weak to moderate positive correlation. This suggests that the organisation's ability to apply knowledge to create value positively influences performance, with this relationship being slightly stronger than that of assimilation. The significance value is again 0.000, confirming statistical significance, ensuring the reliability of these results. Overall, these findings highlight the importance of all three dimensions of absorptive capacity in enhancing organisational performance, with knowledge recognition showing the strongest correlation.

4.2 Discussion of the Findings

The findings of this study indicate that absorptive capacity has a significant and positive impact on the performance of SMEs in the Manzini region, Eswatini (z-value = 0.4958, p < .001). Absorptive capacity was measured through three constructs: knowledge recognition, assimilation, and application. Pearson's regression coefficients revealed a strong correlation between these constructs and performance (two-tailed Sig. = 0.000). Recognising and accessing external knowledge enables SMEs to draw from a broader information base, improving decision-making, problem-solving, and competitiveness. Assimilation further enhances organisational capabilities by integrating external knowledge, fostering learning, and strengthening market positioning.

Overall, absorptive capacity empowers SMEs to recognise, assimilate, and apply knowledge, driving innovation and competitive advantage through the effective utilisation of external knowledge. These findings align with Zhai et al. (2018), who demonstrated that absorptive capacity positively moderates the relationship between entrepreneurial orientation and innovation performance. Their study emphasised the importance of cultivating employees' learning and research abilities to transform and apply new knowledge, thereby supporting growth and innovation.

Similarly, Camilo et al. (2020) found that absorptive capacity, operationalised through external knowledge acquisition, employee training, and innovation subsidies, positively correlates with SME performance. This highlights the role of absorptive capacity in fostering innovation and improving organisational outcomes. The concept of absorptive capacity, as defined by Cohen and Levinthal (1990), is rooted in the ability of organisations to recognise, assimilate, and apply external knowledge for commercial benefits. This view is supported by cognitive and behavioural sciences, which argue that prior knowledge enhances the ability to acquire and use new information. Hilgard (1981, as cited in Cohen and Levinthal, 1990) further posits that memory

development is self-reinforcing, meaning that the more knowledge an organisation stores, the greater its capacity to acquire and apply new information. Additional studies reinforce these findings. Gharakhani and Mousakhani (2012) found that knowledge acquisition, sharing, and application positively impact sales growth, highlighting the importance of developing these capabilities to enhance performance.

Ademu et al. (2021) further revealed that knowledge creation, particularly through socialisation, contributes to competitive advantage among SMEs in Kogi State, Nigeria. Their study underscores the importance of combining knowledge management practices to strengthen organisational performance. Pam et al. (2023) also found that knowledge application and sharing significantly influence SME performance in North Central Nigeria, with an R-square value of 0.186 indicating that 19% of performance variation can be attributed to these factors. Their findings suggest that deploying knowledge effectively can improve organisational outcomes. Collectively, these studies highlight the critical role of absorptive capacity and knowledge management in enhancing SME performance, fostering innovation, and sustaining competitive advantage.

5. Conclusion and Recommendations

This study highlights the significant impact of knowledge management dimensions knowledge recognition, assimilation, and application on organisational performance, revealing that all three are positively correlated, with knowledge recognition exhibiting the strongest relationship. The findings suggest that organisations should prioritise developing effective knowledge management systems and fostering a culture that encourages knowledge sharing and application to enhance performance. By doing so, organisations can navigate challenges more effectively and achieve sustainable growth in a knowledge-driven economy, while also providing a foundation for future research into causal relationships and strategies related to absorptive capacity.

Implications of the Findings

For practitioners, the results highlight the importance of developing robust systems and processes to manage knowledge effectively. The strongest correlation between knowledge recognition and performance (r = 0.494) implies that organisations should prioritise identifying and recognising valuable knowledge as a critical driver of performance. This could involve investing in tools, training, and practices that enable employees to identify and share knowledge effectively. Similarly, the positive correlations for Assimilation (r = 0.323) and Application (r = 0.342) suggest that organisations should also focus on integrating and applying knowledge to create value. For example,

formalising procedures for knowledge integration and fostering a culture of innovation can help organisations better utilise knowledge to improve decision-making and adapt to changing environments.

From a theoretical perspective, these findings contribute to the growing body of literature on knowledge management and its impact on organisational performance. The results support the notion that knowledge management is a multidimensional construct, with each dimension playing a distinct yet interconnected role in driving performance. The stronger correlation for Knowledge Recognition suggests that this dimension may serve as a foundational step in the knowledge management process, upon which assimilation and application build. Future research could explore the causal relationships between these dimensions and performance, as well as investigate how contextual factors (e.g., industry type, organisational size) influence the strength of these relationships.

For policymakers, these findings underscore the need to support organisations in building knowledge management capabilities. Policies that encourage knowledge sharing, innovation, and the adoption of knowledge management systems could help organisations, particularly SMEs, improve their performance and competitiveness. For example, governments could provide incentives for training programs or technology adoption that facilitate knowledge recognition, assimilation, and application.

Limitations of the Study

This study acknowledges several limitations that may impact the interpretation of its findings. Firstly, the reliance on self-reported data can introduce biases, as participants may provide socially desirable responses rather than accurate reflections of their knowledge management practices. Additionally, the sample size, while adequate, may not fully represent the diversity of organisations across different industries, potentially limiting the generalisability of the results. Furthermore, the cross-sectional design of the study restricts the ability to draw causal inferences between absorptive capacity dimensions and performance, as it captures data at a single point in time. Lastly, external factors influencing organisational performance, such as market conditions or leadership styles, were not controlled for, which could affect the observed relationships. Acknowledging these limitations is crucial for contextualising the findings and identifying areas for future research.

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