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THE INFLUENCE OF INCLUSIVE LEADERSHIP ON WORKPLACE INNOVATION IN SMES—A DUAL MEDIATION ANALYSIS OF WORK ENGAGEMENT AND INTELLECTUAL STIMULATION

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ABSTRACT

SMEs make a major contribution to the economy, yet scarcity of resources often restricts their ability to innovate. They contribute more than 40% to the national GDP, provide employment to over 80% of the non-agriculture workforce, and play a crucial role in poverty alleviation and regional development. These firms generate a large share of GDP and jobs, but still struggle with weak finances, poor R&D setup, staff leaving, and little institutional support for innovation. The present research explores how inclusive leadership influences workplace innovation among employees working in SMEs. The study further examines the mediating mechanisms of work engagement and intellectual stimulation. The study uses social exchange, job demand-resources and transformational leadership ideas to explain work engagement and intellectual stimulation. Adopting a quantitative causal and cross-sectional approach as suggest by cavana et al. (2001). Data were gathered from 300 SMEs employees through online survey using convenience sampling technique. Measurement included inclusive leadership 9 items (Carmeli et al ;2010) work engagement 4 items (Schaufeli & Bakker, 2010), Intellectual stimulation 5 items (Avolio & Bass ,2002), and workplace innovation 3 items (De jong and Den Hartog, 2010) on five-point likert scale. Analysis was done through PLS-SEM via smart PLS 4. The measurement model demonstrated strong reliability (Cronbach Alpha 0.779 to 0.929, CR above 0.70), convergent validity (AVE 0.549-0.824) and discriminant validity (HTMT below 0.85). Structural results confirmed all hypothesized paths: IL to WE β=0.579, t=10.44; IL to IS β=0.701, t=18.37; IL to WI β=0.196, t=2.71; WE to WI β=0.320; IS to WI β=0.354, all p<0.01. Indirect effect IL->IS->WI β=0.248, t=5.08 was significant. Explained variance with R2 value of 0.556 for workplace innovation suggests that inclusive leadership serves as a low-cost intervention for SMEs. The findings suggest that inclusive leadership is a cost-effective and sustainable strategy for SMEs to foster innovation without heavy investment in R&D. The study provides theoretical contributions by integrating three theories and practical implications for SMEs owners, managers and policymakers in Pakistan.

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Introduction

In the contemporary global business environment, innovation is now essential for a firm's survival competitive position and lasting growth. Organizations that fail to innovate gradually lose their market share and become obsolete. For large multinational corporations, innovation is often driven through formal R&D departments, large budgets, and advanced technology. However, for Small and Medium Enterprises (SMEs), the situation is entirely different. SMEs generally do not have large R&D budgets, specialized innovation departments, or access to advanced technology. Their innovation depends primarily on their people – employees and leaders.

SMEs are considered the backbone of Pakistan economy, contributing more than 40 percent to GDP and generating substantial employment. Despite this contribution, SMEs face serious obstacles in fostering innovation because of inadequate investment in R&D, elevated turnover and intense market competition (Ishaq & Haleema, 2024; Ahmad 2026). Unlike large organization, SMEs depend heavily on human capital and the behavior of leader to stimulate innovative outcomes. Inclusive leadership, defined by openness, accessibility and availability help employee feel respected and psychological safe (Carmeli et al; 2010), enables employees to feel respected and psychological secure (Edmondson, 1999). Although earlier studies have connected inclusive leadership with creativity, the underlying processes in resource-limited SMEs have receive limited attention. To fill this gap, the study examines two psychological mechanisms: work engagement and intellectual stimulation. Work engagement denotes a motivational condition comprising energy, commitment and deep involvement (khan, 1990; Schaufeli& Bakker,2010). Intellectual stimulation represents a key facet of transformational leadership (Avolio et al;2024) that inspires critical and innovative thinking.

Background:

In the contemporary global environment, concepts of circular economy and sustainable development have become increasingly important. SMEs operating in developing economies often suffer from weak knowledge networks and inadequate institutional support (Zhang et al., 2025). While knowledge sharing is essential for implementing circular economy practices, this area remains underexplored in Pakistan. Research from developed nations highlights leadership as a decisive factor for innovation. In Pakistan, SMEs function within a hierarchical cultural context where employee voice is often discouraged. Inclusive leadership can bridge this gap by cultivating psychological safety, which acts as a link between leadership behavior and innovation outcomes.

Problem statement:

Despite their economic significance, SMEs in Pakistan exhibit low levels of workplace innovation, largely due to constrained and absence of inclusive leadership practices. Most existing studies have examined large organizations in Western settings, overlooking the SME context in developing economies. Very few studies have examined this relationship in the SME context of developing economies like Pakistan. Second, the mechanism through which inclusive leadership leads to

workplace innovation is not fully understood. Does inclusive leadership directly lead to innovation, or does it work through psychological mechanisms? Third, although work engagement and intellectual stimulation have been studied separately, their combined mediating role has not been empirically tested in Pakistani SMEs. Specifically, the problem is: SMEs in Pakistan exhibit low levels of workplace innovation due to resource constraints and lack of inclusive leadership practices. The processes through which inclusive leadership promotes innovation remain unclear. In particular, the mediating functions of work engagement and intellectual stimulation have not been empirically tested in the SME context of Pakistan.

Research Questions

RQ1: How far does inclusive leadership affect innovation at work?

RQ2: Does inclusive leadership affect work engagement and intellectual stimulation?

RQ3: Do work engagement and intellectual stimulation contribute to workplace innovation?

RQ4: Do work engagement and intellectual stimulation acts as mediators between inclusive leadership and workplace innovation?

Significance:

For SMEs, findings reveal that inclusive leadership behavior can enhance innovation without demanding heavy R&D investment, which is crucial given resource limitations (Ishaq & Haleema, 2024). Results show managers can plan HR practices that boost creativity by improving engagement and intellectual stimulation (Ali & Anwar, 2021). This study gives useful direction for developing leaders in Pakistan, where keeping employees and promoting innovation are still difficult.

Literature Review:

Small and Medium Enterprises (SMEs) in Pakistan

SMEs in Pakistan are defined by SMEDA based on number of employees and annual turnover. SMEs operate in diverse sectors including manufacturing, services, IT, banking, textile, and retail. Their innovative capacity largely depends on leadership and employee behavior rather than formal R&D systems (Saunila, 2019). Unlike large firms, SMEs have flat structures, close interaction between leader and employees, and flexibility – which makes leadership even more influential.

Inclusive Leadership

Inclusive leadership was introduced by Carmeli et al. (2010) as a leadership style that emphasizes openness, accessibility, and availability. Openness means the leader welcomes new ideas and listens carefully. Accessibility means the leader can be contacted easily. Availability means the leader stay

available to support employees whenever they need help Shore & Chung (2022). Employees feel part of the organization and feel their individual abilities are recognized. Recent studies (Carter et al., 2023; Wang et al., 2019) have found that inclusive leadership positively influences creativity, innovation, employee voice, and job performance.

Work engagement

Work engagement refers to a pleasant and fulfilling mental state related to one's job, which is reflected through energy, involvement, and deep concentration (Schaufeli & Bakker, 2010). Energy shows mental strength and a strong desire to put effort into work. Involvement shows a close connection with work and a sense of pride in it. Deep concentration shows being so lost in work that a person hardly notices the time passing. This idea was first presented by Kahn (1990). As per the JD-R Model (Bakker & Demerouti, 2007), when leaders provide support to employees, their interest and involvement increase, which positively affects their performance and creative thinking. In a supportive environment, employees feel more active and enthusiastic. Employees who feel emotionally attached to their work are more active in finding new methods and putting them into practice. They do not just finish their assigned duties, but they also search for better ways to improve their work.

Intellectual Stimulation

Intellectual stimulation is one of the four components of transformational leadership (Avolio & Bass, 2002). It refers to the leader's ability to challenge employees to think critically, question old assumptions, and look at problems from new perspectives. An intellectually stimulating leader does not give ready-made solutions; instead, he encourages employees to find their own solutions. Previous research shows that intellectual stimulation promotes creativity and innovation because it pushes employees out of their comfort zone and encourages them to experiment.

Workplace Innovation

Workplace innovation means creating, supporting and applying fresh ideas, methods, products or work processes inside a job role (De Jong & Den Hartog, 2010; Janssen, 2000). It covers both thinking of new ideas and turning those ideas into practical action. In other words, it is not only about being creative, but also about making that creativity useful in real work.

In the case of SMEs, workplace innovation can appear in different forms. For example, it can be a different way of dealing with customers, a new way of promoting products, a changed product design, or a better way of handling internal work.

Hypotheses:

H1: Inclusive leadership positively influences work engagement.

When leaders are inclusive, employees feel valued and become more engaged. Supported by Social Exchange Theory.

H2 : Inclusive leadership positively influences intellectual stimulation.

Inclusive leaders encourage questioning and critical thinking, which stimulates intellect.

H3: Inclusive leadership positively influences workplace innovation.

Direct effect – inclusive leaders create safe environment for innovation.

H4: Work engagement positively influences workplace innovation.

Engaged employees have more energy to innovate.

H5: Intellectual stimulation positively influences workplace innovation.

Stimulated employees think differently and innovate.

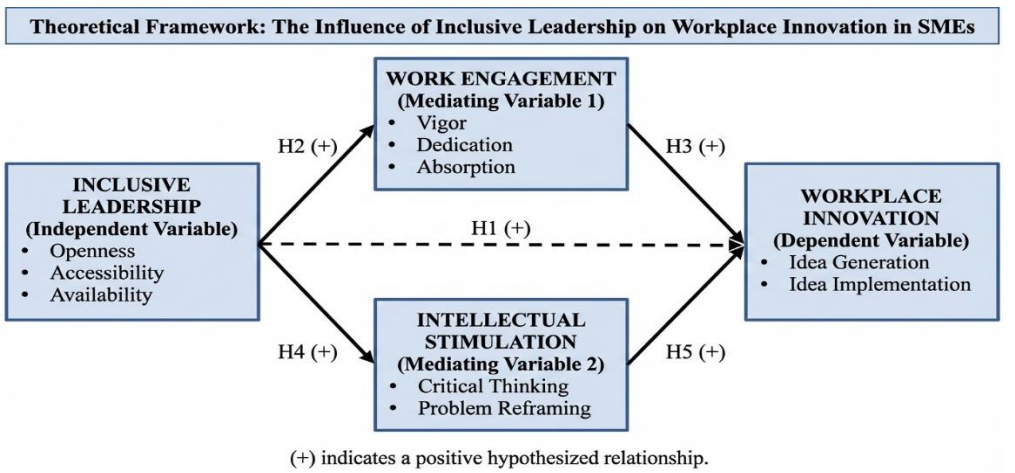
H6: Work engagement works as a bridge between inclusive leadership and work place innovation.

Inclusive leadership improves engagement and improved engagement results in more innovation.

H7: Intellectual stimulation work as a bridge between inclusive leadership and workplace innovation.

Inclusive leadership sharpens thinking, and sharper thinking results in more innovation.

Conceptual Framework:



Research Methodology:

Research Philosophy / Paradigm

The present study follows Positivism. Positivism believes that reality is objective and can be measured through quantitative data (Healy & Perry, 2000). The researcher remains independent from the respondents and tests hypotheses through statistical analysis. This is suitable because the study tests cause-effect relationships between variables.

Research Approach

Quantitative Approach was used. Data were collected in numeric form through closed-ended questionnaire and analyzed through statistical software.

Research Design - Cavana et al. (2001) Framework

According to Cavana et al. (2001), research design has 5 elements:

Purpose of Study: Hypothesis Testing / Causal Study.

The purpose is to test the causal impact of inclusive leadership on workplace innovation through mediators. It is not exploratory or descriptive only.

Type of Investigation: Causal / Correlational.

The study examines cause-effect relationships between independent, mediating, and dependent variables.

Extent of Researcher Interference: Minimal Interference.

Researcher did not manipulate or control the work environment. Data were collected in natural setting.

Study Setting: Non-Contrived / Field Study.

Data were collected from real SMEs in their natural work environment, not in a lab.

Unit of Analysis:

The unit of analysis is the individual.

The focus of this study is a single employee working in an SMEs, as a views about leadership, engagement and innovation differ from person to person.

Time Horizon:

The time horizon is cross-sectional.

Data was gathered from respondents at a single point in time. As suggested by Al-Ahmari & Kattan (2024), cross-sectional design is appropriate for MPhil level due to time constraints.

8.4 Population

Population is the entire group from which sample is taken. Target population = All employees working in SMEs. The accessible population was employees working in SMEs in Punjab, Pakistan, particularly in banking, IT, manufacturing, and services sectors.

Sample Size and Sampling Technique

Sample Size: 300 employees.

According to Hair et al. (2021), for PLS-SEM, sample size should be at least 10 times the number of items or 200+. Our sample of 300 is adequate. Also, Krejcie & Morgan table supports 300 for large population.

Sampling Technique: Convenience Sampling (Non-Probability).

Due to limited time, lack of complete list of SME employees, and accessibility issues, convenience sampling was used. Respondents who were easily available and willing to participate were selected. This is common in SME research in Pakistan (Akpan et al., 2022).

Population, Sampling, Data collection:

Target population comprised employees working in SMEs in Multan, Pakistan. Sample of 300 employees selected using convenience sampling. Sample is young and educated (Akpan et al., 2022). Data collected through structured online questionnaire via Google Forms, distributed through official emails and WhatsApp groups.

Table 1: Characteristics of the Study Participants (N = 300)

Variables	Categories	Frequency	Percentage
Gender	Female	112	37.3%
	Male	188	62.7%
Age Group	18 - 25 years	186	62.0%
	25 - 35 years	90	30.0%
	Above 35 years	11	3.7%
	Under 18	13	4.3%

Highest Level of Education	Bachelor's Degree	193	64.3%
	Master's Degree	99	33.0%
	PHD	8	2.7%
Employment sector	Business owner	20	6.7%
	Private Sector	176	58.7%
	Public Sector	86	28.7%
	Student	18	6.0%
Industry Type	Banking / Finance	85	28.3%
	IT/ Technology	57	19.0%
	Other	126	42.0%
	Telecommunication	6	2.0%
	Textile/Manufacturing	26	8.7%

Instruments

All constructs measured on 5-point Likert scale (Joshi et al., 2015). Inclusive Leadership: 9 items Carmeli et al. (2010). Work Engagement: 4 items Schaufeli & Bakker (2010). Intellectual Stimulation: 5 items Avolio & Bass (2002). Workplace Innovation: 3 items De Jong & Den Hartog (2010). Cronbach Alpha: IL 0.917, WE 0.929, IS 0.823, WI 0.779.

Data Analysis:

Analysis conducted using smart PLS 4 with PLS-SEM technique (Hair et al., 2021). Two stages: measurement model and structural model. Discriminant validity via Fornell-Larcker and HTMT (Ab Hamid et al., 2017). Bootstrapping 5000 resamples.

Table 2: Summary of Latent Variable Results

Variables	Means	S.D
Inclusive leadership	3.63	.67
Work engagement	3.55	.72
Intellectual stimulation	3.63	.76
Workplace innovation	3.74	.87

Measurment model:

Factor loadings 0.645 to 0.911, reliability exceeded. Convergent validity AVE >0.50. Discriminant validity confirmed: sqrt AVE IL 0.741, WE 0.908, IS 0.767, WI 0.833 greater than inter-construct correlations. HTMT <0.85.

Table 3: Discriminant validity – The Fornell-Larcker criterion

Variables	1	2	3	4
1. Inclusive leadership	**0.741**			
2. Work engagement	0.579	**0.908**		
3. Intellectual stimulation	0.701	0.534	**0.767**	
4. Workplace innovation	0.629	0.622	0.662	**0.833**

Table 4: Discriminant validity – HTMT correlations

Variables	1	2	3	4
1. Inclusive leadership				
2. Work engagement	0.624			
3. Intellectual stimulation	0.804	0.621		
4. Workplace innovation	0.738	0.732	0.808	

Table 5: Hypothesis testing

Hypothesis	Relationships	□□	T statistics	P-values	Decision
H1	IL -> WE	0.579	10.444	< 0.001	Supported
H2	IL -> IS	0.701	18.374	< 0.001	Supported
H3	IL -> WI	0.196	2.713	0.007	Supported
H4	WE -> WI	0.320	4.471	< 0.001	Supported
H5	IS -> WI	0.354	5.192	< 0.001	Supported
H6	IL -> IS -> WI	0.248	5.088	< 0.001	Supported

Discussion :

H1 and H2: Strong effect of IL on IS (0.701) shows that when leaders are open and accessible, employees think more critically. Effect on WE (0.579) align with Social Exchange Theory – when leaders treat employees well, they reciprocate with engagement.

H3, H4, H5: Direct effect of IL on WI (0.196) is weaker than indirect effects, which proves mediation is important. This means inclusive leadership alone is not enough; it must work through engagement and stimulation to produce innovation. This finding is consistent with Wang et al. (2019) and Zhang & Wang (2022).

H6 and H7: Both mediations are significant, but IS mediation (0.248) is stronger than WE mediation (0.185). This suggests that intellectual stimulation is a slightly more powerful mechanism.

Practical implications:

For SME Owners:

Adopt inclusive behaviors: listen to employees, invite them to meetings, appreciate their ideas, be accessible, be available. Innovation does not require heavy investment.

For Managers:

Conduct regular brainstorming sessions, idea-sharing meetings, and feedback sessions. Encourage questioning. Do not punish failure; learn from failure.

For HR Professionals:

Design training programs for leaders on inclusive leadership, active listening, and intellectual stimulation. Design engagement programs: autonomy, recognition, rewards, career development.

For Policymakers:

SMEDA and chambers should organize leadership development workshops for SME owners. Include inclusive leadership in SME support programs.

For Employees:

Speak up, share ideas, participate in decision-making, take initiative. Inclusive leaders will support you.

Theoretical implications:

Integration of Three Theories:

This research is among the limited studies that bring together Social exchange theory, JD-R model, and transformational leadership theory in a single framework. It shows that these three theories support one another.

Extension to SME Context:

It takes inclusive leadership research from big Western companies to small and medium enterprises in a developing economy.

Dual-Mediation Model:

It tests a Dual-mediation model which had not being examined earlier in Pakistan.

Methodological Contribution:

It shows the use of PLS-SEM in SME research in Pakistan.

Limitations:

Although this research makes useful contributions, it has some weaknesses which must be mentioned.

Cross-sectional design limits causality.

We cannot confirm that inclusive leadership directly causes innovation; we can only say that they are connected. A longitudinal study would be required.

Convenience sampling limits generalizability.

Probability sampling would give more reliable results.

Self-report bias

Data was taken from one source only (employees) through a self-report questionnaire. Employees may have given answers that look socially good. Taking data from multiple sources (leader + employee) would be better.

Young sample

Around 62% were aged 18-25, so the findings may not apply to older employees.

Only two mediators studied.

Other factors like psychological safety, knowledge sharing, trust, and creative self-efficacy could also be important.

Single country

The study was done only in Pakistan, so the results may not apply to other countries.

No moderators studied

Factors like organizational culture, digital transformation, or gender could change the relationship.

Recommendations:

- Use longitudinal design to establish causality.

- Collect data from multiple cities (Lahore, Karachi, Islamabad, Faisalabad, Hyderabad) and multiple industries.
- Include additional mediators: psychological safety, knowledge sharing, creative self-efficacy, trust.
- Include moderators: organizational culture, digital transformation, gender, age.
- Use multi-source data: collect leadership data from leaders and innovation data from employees, or use supervisor ratings.
- Compare SMEs with large firms to see differences.
- Use mixed-methods: combine quantitative survey with qualitative interviews to get deeper insights.
- Study the role of digital leadership and AI in innovation.

Conclusion:

This research provides strong evidence for positive direct and indirect relationships between inclusive leadership and workplace innovation in SMEs of Pakistan. Leaders who demonstrate openness, accessibility, availability, and supportiveness create a culture where employees feel valued, psychologically safe, engaged, and intellectually stimulated, which enhances innovation. The study shows that inclusive leadership is not just a nice-to-have leadership style; it is a strategic, cost-effective, and sustainable method to improve innovation in resource-limited SMEs. In a country like Pakistan where SMEs are central to economic development, employment generation, and poverty alleviation, the role of inclusive leadership will continue to grow in importance. Organizations that invest in developing inclusive leadership competencies will be better positioned to innovate, compete, survive, and grow in the dynamic and competitive business environment. SME owners, managers, and policymakers should prioritize inclusive leadership development as a key strategy for enhancing innovation and achieving sustainable growth. As Pakistan moves towards digital transformation, circular economy, and sustainable development, inclusive leadership will be even more critical. It will enable SMEs to adapt to change, to embrace new technologies, to engage young talent, and to contribute to national development.

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