

# THE ROLE OF PRODUCT INNOVATION FOR THE INTERNATIONALIZATION OF SMALL AND MEDIUM-SIZED ENTERPRISES (SMEs)

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## ABSTRACT

Internationalisation of business is not limited solely to large and multinational corporations alone, today the business world has witnessed many case scenarios where Small and Medium-sized Enterprises (SMEs) are predominantly gaining a wave and spaces at the international market. The growing share in the developed and even in the developing economy explains their strong participation to the internationalisation. The aim of this paper is to examine how small and medium-sized enterprises internationalise by using innovative approach to their product development, and how this influences their internationalisation process. The focus therefore is on obtaining better understanding of the role of innovation for the SMEs as a driver for their participation at the international market environment. The paper adopts a literature survey where extant literatures are reviewed with a view to gaining an insight into the role of innovation in the internationalization process. The paper concludes that being innovative and vast in R&D can lead to gaining many accesses to the international market, seeking more opportunity and discovering new market for products and services. It recommends that managers of SMEs should focus on new technology, effective Research and Development, and try to be responsive to market changes in the industry they belong to. This can be achieved by having an effective and efficient management that values innovation for change not for fashion.

**Keywords:** Internationalization, innovation, SMEs, entrepreneurship, technology innovation,

## INTRODUCTION

Internationalisation and entrepreneurship among Small and Medium-sized Enterprises (SMEs) is a topic of considerable relevance, principally owing to observed growth effects of cross-border venturing, and the demonstrated capacity of SMEs to drive economic development at national, regional and global levels. SMEs internationalisation is perceived as an important aspect to look into, and do anything to promote its gravity across the globe, and remains of considerable contemporary relevance (OECD, 2008). SMEs are important components of economic development due to their flexibility and innovative characteristics. SMEs are not usually thought as international players, but in fact they play a significant role in the international economy, and about one per cent (1%) of SMEs are global players (OECD, 2004). In very general terms, SMEs contribute between fifteen per cent (15%) and fifty per cent (50%) of exports and between 20% and 80% of SMEs are active importers. Overall, it is estimated that SMEs now contribute

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between 25% and 35% of world manufactured exports (OECD, 2004). Thus, internationalisation of SMEs has in recent years attracted research and policy attention. Yet, it is not clear what skills and capabilities an SME needs to succeed in the international marketplace. More specifically, an important question is whether and to what extent innovation plays a role in SMEs internationalisation?

The answer is simply to be as much innovative as possible. The innovative and entrepreneurial capabilities help to improve economy through their international involvement and domestic employment generation. Their growing share in global activities induced many writers to focus on SMEs internationalisation. However, SMEs increasing number in international involvement explains how strong they compete and fully participate in internationalisation (Coviello and McCauley, 1999). Dynamically, those SMEs that are internationally active are generally growing faster than their domestic equivalents. It is hard to get an accurate gauge on just how fast they are growing, but two to three times average rate of growth of OECD economies is probably not reasonable (Hall, 2004). This suggests that internationalised SMEs are making a significant contribution to the growth of the world economy. This is the major reason why many scholars engage in studying the overall importance of the SMEs in relation to regional and economic growth (Li, 2008).

The aim of this paper is to explore the dimension of the small and medium enterprises internationalisation through innovation. The purpose of the study is to examine how small and medium-sized enterprises internationalise by using innovative approach to their product development, and how this influences their internationalisation process.

### **SMALL AND MEDIUM-SIZED ENTERPRISES**

There are many definitions in the selected literature about what Small and Medium-sized Enterprises are all about. One issue about SMEs definition is that certain criteria have been used to define what SME stands for most especially according to countries, size and sectors. Conrad and Darren (2009), cited in Lucky and Olusegun (2012), explain that the main reason why SMEs definition varies particularly from industry to industry; country to country; size to size and number of employee to employee is to reflect industry, country size and employment differences accurately. SMEs represent a business and not a public limited company. They are businesses in India having not less than 250 workers in the case of manufacturing and service industries including trading businesses (Jasra, Khan, Hunjra, Rehman and Azam, 2011) also cited in Lucky and Olusegun (2012). The above point shows that the common criteria for defining SMEs are employment, number of employees, size, industry, country and asset value. In Nigeria, the definitions of SMEs focussed on are small firms leaving a gap in the definition of medium enterprises. Ogudele (2007) defines SMEs as a business with minimum of 5 employees with minimum capital outlay of not less than five thousand Naira (\$33).

The Medium businesses as the name suggests are bigger than both micro and small businesses in terms of operations, manpower capacity or number of employees, structure, capital investment and size. According to Darren et al. (2009), they are the businesses that employ up to 249 employees in UK, in European Union, they employ up to 250 employees, in Australia, they employ up to 200 employees while in U.S.A, they accommodate up to 500 employees.

A major characteristic of Nigeria's SMEs relates to ownership structure or base, which largely revolves around a key man or family. Hence, a preponderance of the SMEs is either sole proprietorships or partnerships. Even where the registration status is thus that of a limited liability company, the true ownership structure is that of a one-man, family or

partnership business. Other common features of Nigeria's SMEs include the following among others (Onugu, 2005)

- a. Labour-intensive production processes
- b. Concentration of management on the key man
- c. Limited access to long term funds
- d. High cost of funds as a result of high interest rates and bank charges
- e. High mortality rate especially within their first two years
- f. Over-dependence on imported raw materials and spare parts
- g. Poor inter and intra-sectoral linkages - hence they hardly enjoy economies of scale benefits
- h. Poor managerial skills due to their inability to pay for skilled labour
- i. Poor product quality output
- j. Absence of Research and Development
- k. Little or no training and development for their staff

### **INTERNATIONALIZATION**

The process by which firms increase their awareness of the direct and indirect influences of international transactions on the future, establish and conduct transactions with other countries (Beamish, 1990). Internationalization of a firm is a process in which the firms gradually increase international involvement (Johanson & Vahlne, 1994). It is also described to be a cumulative process in which relationships are continually established, maintained, developed in order to achieve the objectives of the firm (Johansson and Mattsson, 1993). These definitions are quite interesting but viewed internationalisation as the process of developing networks of business relationships in other countries through extension, penetration and integration. This paper aims at looking at the innovation as the process of firm's internationalisation, especially the Small and Medium sized Enterprises.

### **CONCEPTUAL PERSPECTIVE AND RESEARCH ISSUES**

It has been said that "a nation's competitiveness depends on the capacity of its industry to innovate" (Porter, 1990) but it is increasingly difficult to come up with new products in the face of intense global competition of present business environment (Jerrard, 1998). The new product literature is vast and growing. After all, developing a new product and service is one of the core business or organisational concern- and, one could argue, the most important process. The growing interest in the behaviour of SMEs internationalisation refocuses attention on the role the innovation plays for their development at all levels, ranging from economic development through job provision and competition and important culture of innovation. A variety of disciplines engage in research and publishing articles on product development and innovation complimenting the work of people like Joseph Schumpeter(1930) and David Keeble, due to the importance of the concept in today's business. SMEs have today embraced innovation as their source for gaining competitive advantage at the international environment (Zheng, 2008).

This section aims at surveying the literature on two dimensions; exploring the importance of new product innovation at the high tech SMEs and the internationalisation process. The reason for choosing this literature is that our understanding of SMEs success in terms of product development and internationalisation is currently limited. They provide theoretical basis for exploring the importance of innovation for SMEs internationalisation process.

### **Relation to Entrepreneurship Field of Research**

Innovation is located in the field of entrepreneurship, a concept which for over centuries has been in business and economic literature (Morris et. al, 1994: cited in Abubakar, 2009). As a general field of research, entrepreneurship seeks to understand how opportunities to bring into existence future goods and services are discovered, created and exploited by whom and with what consequences (Shane and Vankataraman, 2000). Entrepreneurs use innovation to exploit or create changes and opportunity for the purpose of making profit. They do so by shifting their economic resources from area of lower opportunity into area of higher productivity and greater yield, accepting a high degree of risk and uncertainty (Burns, 2007). Therefore, innovation cannot be separated from entrepreneurship as it is the life blood for entrepreneurs' success in business, also regarded as a tool of entrepreneurship by Burns (2007). Today, many people refer entrepreneurship as innovation synonymously. Entrepreneurship and innovation are two important elements which are derived in nature that one cannot go without the other. Entrepreneurship has also been defined as the creation of new organisations (Gartner, 1985, 1988). The concept has also been defined as dynamic process of creating incremental wealth (Ronstard, 1984). The wealth here is created by the individual who put in their resources in form of money and time to get profit. In this context, since the research seeks to explore whether product innovation offers opportunity for SMEs internationalisation we need an operational definition that will show clear connections with the topic of discussion. Thus, entrepreneurship in this research refers to the study of sources of opportunities through which future goods and services are discovered and exploited (Vankataraman, 1997; Ventakaraman, 2000). This definition is adopted here because it relates to the topic and new product development, and importantly due to the authorities contributions involved. The emphasis on small firms is because small firms are viewed as relatively more innovative compared to large firms especially in high-tech industries (Acs and Audretsch, 1987; Acs, 2002). The study is generally related to the field of entrepreneurship as the heart of entrepreneurship is alertness which relates to searching for the market for the opportunity that could be turned into better goods, new products or less expensive goods to the market (Abubakar, 2009). Alertness here according to Abubakar,(2009) means seeing outside the box of routine ways of getting things done, especially as it relates to new product, alertness means the process of discovering new knowledge that others have not yet noticed, alertness is simply the product innovation.

One important way of getting opportunity for product innovation to entrepreneurial firms is through changes in technology, as technological opportunities are potentially innovative and break away from existing knowledge (Acs, 2005). Therefore the major source of opportunity is simply the amount of innovation available in place by entrepreneurial firms (Drucker. 1985). Technology is therefore an important part of entrepreneurial opportunity today in realising the ultimate goal of business entrepreneurship as it makes possible for people and organisations to allocate resources in different and potentially more productive ways (Casson, 1995). Soon after the Second World War II, the work of Joseph Schumpeter has appeared to show a clear relationship between entrepreneurship and innovation, thereby drawing interest on the importance of innovation in business activities for success, development and economic growth. According to Schumpeter, at the centre of innovation process is the entrepreneur who initiates changes and generates new opportunities which exploits commercial gains (Abubakar, 2009). Therefore, technology is an important source for innovation and entrepreneurial opportunity, and will therefore form the basis for this paper. We therefore found it necessary to clarify the important link between technology and innovation.

### **Technology Innovation: New Product Innovation**

For Schumpeter (1996), a normal healthy economy is the one that is continually disrupted by technological innovation. Silicon Valley in California is synonymous with innovation (Smith, 2006). It is the quintessential example of a place that is all about innovation as Schumpeter views. Nowhere else in the world is so readily identified with new product and new services. It is not merely the number of firms that innovate in the valley that matters, it is the fact that Silicon Valley has gone on producing wave and wave of innovations (Smith, 2006). There are other places in the world that have stronger records in scientific discoveries and scientific breakthroughs, for example Cambridge in the UK has quite outstanding records in terms of scientific breakthroughs that include: discovery of electron, splitting the atom, and the identification of DNA. Though these achievements are the stuff of Nobel prizes as such are highly significant, they are scientific breakthroughs rather than innovations (Smith, 2006).

Innovation is the result of an entrepreneur converting ideas, concepts and opportunities into marketable products and process. Innovation is the means by which the entrepreneur implements changes. If successful, this change will lead to economic advantages of the firms; and this economic change is simply the PRODUCT innovation (McDaniel, 2002), which is the main focus of this paper.

Probably there are as many definitions of innovation as the number of supposed experts on the field around the world (Daniel, 2009). It has been given several definitions by several writers and scholars. Those definitions include the following: an innovation is an idea, practice or object that is perceived as a new by an individual or other unit of adoption (Rogers, 1995). Mitra (2008) defined it to be a successful exploitation of new ideas. According to Mitra's view mobilisation of knowledge, technological skills and experience to create new products and or services for diffusion in the market place is what referred as innovation. According to Betje (1998) innovation is a new thing applied in the business of production, distributing and consuming products or services. It is also viewed as the commercial application of a new process or products (Freeman and Soate 1997). In a nutshell, we can simply use the contribution of Acs and Audretsch, (1992) to describe innovation as a process of developing a new item, the process of adopting a new item and a new item itself. Therefore, this will take us back to Mitra's view of successful exploitation of new idea in product or service to make more unique to the users and to withstand the competition. Innovation is all about something entirely new to the market in terms of quality or features.

### **INTERNATIONALIZATION AND SMEs**

Globalisation encompasses a wide range of issues and developments. It includes changes in business strategies in production, marketing, finance, and research and development (R&D). The increase in globalisation has significantly influenced global trade and investment. Rapid technological changes in communications and increasing trend towards significant change in the structure of industry and business competitiveness necessitate SMEs to become global. Globalisation has created greater incentives and opportunities for SMEs to access the various markets and knowledge sources needed to build a lasting international commitment and competitive advantages through international market and continuous innovation (OECD, 2000). As well, it has brought new competitors for SMEs in industrialised world, especially in countries with high technology like the UK and US. SMEs need to search for competitive advantages across national borders in order to sustain their existence more efficiently. To achieve this end, they have to internationalise their business activities beyond a single operational geography to a more diverse territory. Traditionally, competition in international business has been the reel of larger firms (Etemad and Wright 2001), while

smaller firms remained local, but that was the story of before because today SMEs can compete with any form of business origination due to their immense innovative activities. Therefore, today size is not an issue when it comes to innovation because SMEs are the topic of discussion in that regards. Consumers today want the best with little concern where products are produced provided that they satisfy the overall taste of the customers in terms of the features and the general benefits composed in the product. As the businesses become more integrated into globalised arena, there is an increased strength in the side of the SMEs to need an intensified support in their activities to become globally competitive. In this heading we will explore the meaning of the internationalisation and relate it to SMEs.

Internationalisation of SMEs may come in different forms. Johnson & Mattson (1999) identified three process of internationalisation. First, that the firm has to develop a source of competitive advantage in its domestic market by being very innovative in their products to gain strong market share, and if this advantage cannot be efficiently exploited domestically, then the firm has to move on and seek for the opportunity abroad. A good example of this is the case of Alibaba.com a firm whose massive innovation in terms of technology assisted in going far to the global trading. Two, the process of increased international sales and production and lastly, the network approach which focuses on the relationships between companies. Madhumita, (2008) viewed internationalisation as the act of bringing something under international control using any methods possible to get through the process. SMEs today have realised that the major opportunity for them to rub shoulders with their larger firm's counterparts is to innovate massively on products or service they are dealing with. Many SMEs operating across the border today have achieved that through product innovation. According to Gleave (2008), the increase in number of firms (SMEs) in the international market results from the following reasons: -

- a) Increase in innovation activities by the Small and Medium-sized Enterprises (SMEs),
- b) Increasing networks by SMEs across geographical borders,
- c) Globalisation, and
- d) Government's support for innovation activities.

#### **FIRM'S FOREIGN MARKET ENTRY MODE**

According to Kotler & Keller (2006) as cited in Tahir and Mehmood (2010), firms adopt four approaches to enter in the international market: exporting, licensing, joint venture and direct investment. The most common way firms adopt to enter in the international market is exporting activities. The firms sell their product in foreign country to expand their business globally. According to Kotler and Keller (2006), firms can adopt direct and indirect approaches to start their exporting activities. In case of direct exporting activities, firms handle its export activities by itself. Firms establish a network of their representative in the international market. While in indirect approach strategies, firms did not handle its export activities by itself but the company works through independent intermediaries. Lindh (2009) also cited in Tahir and Mehmood (2010) maintains that the intermediary of the firm may be a domestic buyer or export agent who buys the firms product and exports it into international market.

The second entry mode firms adopt to start their internationalization process is through licensing. Firms did not sell their product by itself but issue license to a local company to use its manufacturing process, trademark etc. Kotler & Keller (2006) described that the

advantage of the licensing method for firms is that firms enter in the international market with a little risk. However this method also involves risk for the firms, if the license is terminated, the firm has a threat of potential competitor in the new market. (Lindh, 2009)

The third entry mode firms use to enter in the international market is via joint venture. Company makes partnership with foreign company to share the ownership and control of the firm. Kotler & Keller (2006) described that the firm establish partnership with firms in the foreign country if the firm has limited resources, market knowledge and investment to start their operation or if it is a requirement in the host country. This method also has disadvantages, in case of joint venture it is some time hard for firms to carry on worldwide policies. (Lindh, 2009)

The last method according to Kotler & Keller (2006) firms use to enter in the international market is by making direct investment in the host country. Firms can start its own production facilities in the host country by purchasing a local company or by building its own production plant. Although in this method firms has full control on its operations but the disadvantage of the method includes devaluing the country's currency and blocking the heavy firm's investment. (Lindh, 2009)

## **CONCLUSION**

The study concludes that innovation plays a pivotal role for SMEs' global penetration of both market and dissemination of new products. The activities of SMEs confirm that massive innovation is the yardstick for the internationalization of the small firms. They do that by engaging in Research & Development which was before related to larger firms alone. R & D in Small and Medium-Sized Enterprises is the key for their excessive innovative capacity which leads to their internationalization. Being vast in R&D can lead to gaining many accesses to the international market, seek more opportunity and discover new market for their products/services. SMEs are very important for the economic development of any nation and their present participation has boosted regions and nations. Therefore, for SMEs to become fully globalised, they have to develop a source of competitive advantage domestically which will enable them to gain strong market share. This they can do only by being highly innovative in their business. This will tremendously boost their potential of becoming international. The paper recommends that the managers of the existing SMEs should focus on innovation for them to achieve the success of global trading. They should focus on new technology, effective Research and Development, and try to be responsive in nature to the market changes in the industry they belong to. This can be achieved by having an effective oriented management that values innovation for change not for fashion. In addition, all small businesses should try to have a global focus in their affairs as this will boost their level of thinking and realize the opportunity of networking and Foreign Direct Investment (FDI).

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