THE EFFECT OF PRODUCT DEVELOPMENT AND INNOVATION ON SMES EXPORT PERFORMANCE

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Abstract

The largest trading partner of the Republic of Serbia is the European Union and in the last years a constant trade growth has been recorded. Further implementation of economic reforms and gradual free trade of industrial products with European Union are directed towards achieving better export performance. The industry of export-oriented value-added products must be supported by direct and indirect economic policy measures adequately targeting innovation and product development. In the European framework it has been proven that innovations have a direct influence on the export performance. The empirical investigation in Serbia reveals that product innovation has a significant impact on export performance. The objective of the paper is to explore the relationship between product development and SMEs export performance by using data collected by a questionnaire from a sample of Serbian exporters. Statistical methods that shall be used are Pearson Chi-square test, correlation and regression analysis. Consistently with the predictions of the theoretical findings, the research results suggest a positive effect of product quality on export performance, as SMEs that invest in product quality are more likely to reach satisfactory export results.

Key words: *product development, innovation, export performance, small and medium enterprises, Republic of Serbia, European Union*

Introduction

In today's economy the survival and development of the economy is dependent on its integration with world markets and trends in the international economic environment, and in our particular case, the necessary links with European countriers and Western Balkan countries which are the main foreign trade partners of Serbia. The foreign trade is for the Republic of Serbia, one of the

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most important economic activity for enhancing the competitiveness, directed towards a greater integration into the Single Market of the European Union.

SMEs have a significant role in accelerating the process of economic growth and development, GDP growth and reduction of unemployment rate in the Western Balkans. Especially in developing economies, SMEs are important source for the overall economic development having a direct impact on the employment, economic welfare, investment attraction and social stability. SMEs represent the vast majority of productive activities in the Western Balkans. According to Irwin (2007) economies with high proportion of SMEs will be more resilient to external shocks and will be more likely to have more firms which grow into larger business. Many SMEs in Serbia still do not have a clearly defined strategy of internationalization, nor the knowledge and ability to identify potential partners and assess the market potential.

SMEs in Serbia providing 65,1% of total employment have a share of 65,4% in total revenue and 55,8% of GDP (Report on SMEs and entrepreneurship in Serbia, 2013). In the EU, 80% of all export companies are exactly SMEs which exported about 600,000 different goods (Cernat, Norman-Lopez and T-Figueras, 2014). The participation of these companies in the total export of the EU amounted to 34%, which is lower than in Serbia, where SMEs make 48.9% of export revenues (Ministry of Economy, Ministry of Regional Development and Local Government, National Agency for Regional Development, 2013). Although the export of Serbian companies began to improve in recent years the obstacles to the export are still the costs, time and number of required documents. Western Balkan exporters are currently concentrated on the markets of the EU and CEFTA countries that receive the largest part of region exports (Vapa-Tankosić, Carić and Jevtić, 2011).

Table 1 *Participation of SMEs in total income, employment and export in Serbia*

	TYPE OF SME	SERBIA (% participation)
Total income	Micro	39,3
	Small	31,1
	Medium-sized	29,6
Employment	Micro	45,2
	Small	25,1
	Medium-sized	28,7
Export	Micro	23,0
	Small	28,6
	Medium-sized	48,4

Source: *Extrapolation of data from Report on SMEs and entrepreneurship in Serbia (2013)*

The paper highlights the importance of the SMEs sector in the Republic of Serbia and analyzes the relation between innovation and exports. The link between innovation and exports performance has been much discussed in literature attempting to answer the question whether more innovative firms are more likely to export. This paper defines innovation activities in three different ways: a new product innovation, a new production process and a modification of existing products. The authors by using data collected by a questionnaire from Serbian exporters shall investigate a direct influence of product quality on export performance.

Determinants of export performance

Since the 1960s determinants of export performance have been attracting attention from international scholars as one of the most investigated issues. Many theoretical frameworks of export performance have been formulated in the past period by Zou and Stan (1998), Leonidou, Katsikeas and Piercy (1998), Katsikeas et al.(2000), Leonidou, Katsikeas, and Samiee (2002), Shosham (2002), Sousa (2004), Ruppenthal and Bausch (2009).

Katsikeas, Leonidou and Morgan (2000) have analyzed more than 100 empirical studies on export performance with different conclusion caused by differences in methodology, context, external environmental factors, and statistical analysis. Shoham (1998) identified 29 measures of export performance, while Sousa (2004) reviewed 43 empirical studies and noted 50 different operational aspects of export performance. In the qualitatively review of existing research of 91 studies Ruppenthal and Bausch (2009) conclude that the company, industry and institutional and/or market factors are major causes for variations in export performance.

Mariotti and Piscitello (2009) reveal that that firms' export performance depends on their international experience and network structure. By comparative analysis of samples from Germany, Finland, Japan, South Africa and South Korea, Dichtl et al (1990) identified that export market orientation of decision makers constitutes an important determinant of export performance. A lot of studies have used a countless number of independent variables to assess export performance. The model of Abby and Slater (1989) is still the most cited simplified model in international literature. Aaby and Slater (1989), Leonidou, et al. (1998) and Zou and Stan (1998) grouped the explanatory variables as external (industry, domestic and foreign market characteristics) and internal (managerial and firm characteristics). On the other hand, export performance of firms has been measured by diffrent indicators, such as sales,

market growth, market share, profitability, return on investment, perceived satisfaction and fulfillment of export goals (Julian, 2003).

Innovation as an export performance stimulus or vice versa?

Innovation is conceived as a quality improvement strategy that allows firms to increase the presence on the market. The key proposition is that firms that invest in better quality products are more likely to export.

Table 2 *Strategic advantages through innovation*

Mechanism	Strategic advantage
Novelty in product or service offering	Offering something no one can
Novelty in process	Offering it in ways others cannot match (faster, lower cost, more customized)
Complexity	Offering something which others find it difficult to master
Legal protection of intellectual property	Offering something which others cannot do unless they pay a license or other fee
Add/extend range of competitive factors	Move basis of competition -from price of product to price and quality, or price, quality, choice
Timing	First-mover advantage - being first can be worth significant market in new product fields
Robust platform design	Offering something on which other variations can be built
Rewriting the rules	Offering something which represents a new product or process concept– a different way of doing things – and makes the old ones redundant
Reconfiguring the parts of process	Rethinking the way in which bits of the system work together -building more effective networks, outsourcing
Transferring across different application contexts	Recombining established elements for different markets
Others	Innovation is all about finding new ways to do things and to obtain strategic advantage so there will be room for new ways of gaining and retaining advantage

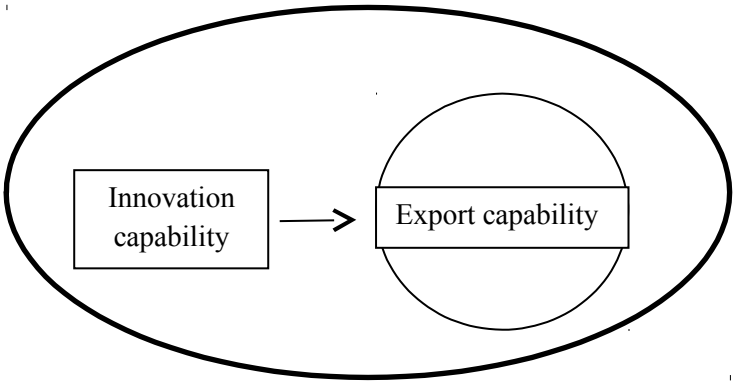
Source: *Tidd, J., Bessant. J. and Pavitt, K. (2005, p. 8,9)*

Whether innovation causes exports (theory of self-selection) or exports stimulate innovation (theory of "learning by exporting") is an ongoing question posed by many researchers in recent literature.

- *Theory of self-selection*

The first theory states that innovative firms self-select to operate in international markets, whereas less innovative firms are unable or unwilling to penetrate foreign markets. This theory relies on the hypothesis that only those firms who are efficient enough and can incur entry costs and strong competition of the export market will start exporting. SMEs may offer low-quality goods in domestic markets, but they must invest in technologies that produce high-quality goods if they wish to enter foreign markets. „Innovation is thus a precondition for export. Entry into the export market is also costly, but the firm's decision to export occurs after it gains knowledge of its productivity" (Meliz, 2003, p. 1695).

Figure 1 *Graphical representation of the self-selection theory*



Source: *authors' elaboration*

From the perspective of product innovation, Roper and Love (2002) have perfomed a research on the impact of innovation on the international performance of German and English manufacturing companies concluding that the nature of the impact of innovation on export depends on the context of the company (country of origin, size, and business sector) as differences in the abilities of innovators and non-innovators to absorb the effects of spill-overs are not consistent across countries, and may be a function of the international competitive position of the country. "The exporting behaviour of German plants becomes less affected by spill-over effects when they

innovate as the act of innovating seems to make the resource endowments, internal capabilities and internal organisation of the individual plant more important in the decision to export, while these factors become relatively less important for the UK plants' exporting decisions after innovation occurs" (p.1100).

According to Imbriani, Morone and Testa (2008) "firms introducing either process, product, organisational or marketing innovations are, on average, between 4 to 8 percentage points more likely to export than firms that do not innovate, as producing quality products increases, ceteris paribus, future export's decisions by almost 4 percentages points" (p.19).

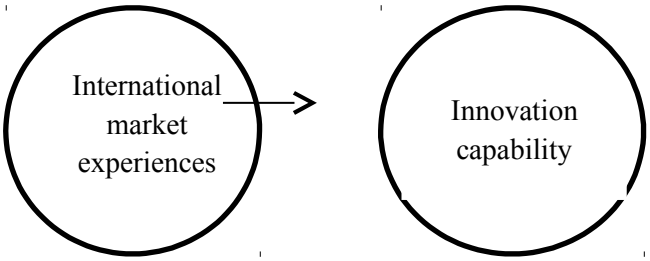
Morone, Renna and Testa (2013) conducted an investigation of Italian SMEs in manufacturing sector and divided their innovative activities into technological (product and process innovation) and non-technological (organisational and marketing innovation). A strong complementarity between these two classes of innovating activities has been observed as for the decision of penetrating new foreign markets, confirming the general view that product and process innovations request organizational and marketing changes in order to effectively stimulate productivity and international competitiveness. For example, the authors point out that non-technological innovations increase the probability of looking for new markets abroad by 12.5 percentage points while technological innovations increase such probability by 8.7 percentage points. However, a firm that incurs both forms of innovation at the same time will increase the odds of reporting plans to increase its export by 18.2 percentage points.

- *Theory of Learning by exporting (LBE)*

Learning by exporting represents a hypothesis that assumes that an improvement of firms' performance (productivity) shall occur only after entering export markets, as a consequence of an exploitation of the experience acquired on foreign markets. Learning from exporting is connected to knowledge and efficiencies gained from participation in international markets which may be applied to companies in poor countries that are in a position of learning from their foreign partners (Blalock and Gertler, 2004). External knowledge via exporting can push companies to innovate (Salomon, 2006). "The case study evidence points to the importance of learning from foreign markets both directly, through buyer-seller relationships, and indirectly, through increased competition from foreign producers. In particular, exporters can learn from foreign

customers and rivals by improving product quality, shipment size, or, even more directly, by undertaking specific investments" (De Loecker, p.1). The author by using micro data from Slovenia also finds evidence of substantial productivity gains from entering export markets.

Figure 2 *Graphical representation of the learning-by-exporting theory*



Source: *authors' elaboration*

Permanent exporters engage in product innovation in greater intensity than do sporadic exporters but this difference is not so significant. However, significant differences exist for process and organizational innovation. The results (Alvarez, 2004) show that permanent exporters innovate more than sporadic exporters in outsourcing and the computer-based modernization of productive processes. As for organizational innovation, permanent exporters are more innovative in terms of introducing re-engineering into administrative processes and in total quality development.

Wu (2013) has analyzed Chilean manufacturing plants from 2001 to 2007 to conclude that higher export ratio or longer exporting experience significantly raises the productivity ONLY among those plants with asset innovation investment (over 100 million pesos). For other plants' exporting cannot effectively improve their productivity, so in this context "learning-by-exporting" hypothesis has not been confirmed in case of low-innovation circumstance. He also states that "the learning-by-exporting hypothesis is neither absolutely right, nor absolutely wrong. In the real world, we need to consider other specific, micro-level details, for example, innovation behavior, before we can decide the likelihood of the existence of the learning effect" (p.79).

The study of Love and Roper (2015) the link between innovation and export in the context of SMEs indicates clear synergies between innovation and exporting with outlining that more research is required to be certain

that the *innovation–exporting–performance* nexus operates as clearly for SMEs as it does for larger firms. They also stress the need of coordinated policy support, with either a single agency responsible for both innovation and export support or at least a close alignment between policy on both areas.

The research work by Enjolras, Camargo and Schmitt (2016) does not analyze innovation and export in terms of impact of the one on the other but gives an impetus to considering them as two complementary activities mobilizing common capabilities (resources, skills, knowledge) which an SME has to mobilize primarily to create simultaneously value in terms of innovation and export.

Liu and Rammer (2016) have analyzed the importance of public financial support as they find evidence in Germany that European Union and national technology programs contributes to a higher innovation output from both product and process innovations of SMEs. Alternatively, funding programs supporting innovations that copy or adapt products of other firms, or that help SMEs to implement more cost-efficient processes, do not contribute to higher export success. The positive relation between a program's support to new-to-market innovations and an SME's export performance is particularly strong for national technology programs and European funding.

Metodology

The key research objective of the paper is the relationship between product features and export performance. The survey instrument has been designed using three point Likert categorical scale. The survey was conducted by means of an unstandardized questionnaire that has been created for this research. The method of data collection was telephone and via e-mail. For the enhanced representativeness of the sample, the survey covers SMEs from a diverse spectrum, from the production and export of alcoholic beverages, agricultural machines, cables and generators, electrical appliances, furniture, clothing, telecommunications equipment, which contributes to the the quality of research. The survey was conducted over a period of six-months, from January to June 2016. Although we had sent 120 questionnaires, 50 replies were returned and they constituted an effective response rate of 42%. As the share of export of the analyzed companies in total export of the Republic of Serbia is rather significant, we came to a conclusion that the group constitutes a representative sample for the

research. The majority of respondents were male managers. Consequently the data was analyzed using SPSS for Windows 20.0. Descriptive statistics were used to describe the characteristics of the study sample and Pearson Chi-square test, as well as correlation analysis and regression analysis. The survey was modelled on Leonidou, Katsikeas, and Samiee (2002).

Discussion and research results

In the context of a comprehensive presentation of the results, the impact of the independent variable (product) on the SMEs export performance (sales volume on foreign markets, the share of the foreign market and the profitability of exports) has been analyzed. In this way, the authors were able to gain precise information as to whether the impact is present, and if so - to what extent the individual impact of each element of product features, or of all the elements of export performance of the company, is relevant. Also, the relation analysis of the independent variable (product features) and the SMEs export performance by correlation analysis.

Table 3 *Descriptive indicator of the variable – product*

Product	Not present		Moderately present		Fully present	
	Frequ-ency	Percen-tage	Frequ-ency	Percen-tage	Frequ-ency	Percen-tage
Capacity to meet foreign customers' product quality	1	2%	15	30%	34	68%
Capacity to meet foreign customer' design/packing preferences	3	6%	22	44%	25	50%
Recognized brand on foreign markets	16	32%	23	46%	11	22%
Capacity to meet warranty/service requirements of foreign customers	5	10%	13	26%	32	64%

Source: *authors' calculation*

Based on the results in Table 3 it can be seen that the majority of companies (68%)consider that they have the capacity to meet the necessary quality of foreign customers' product quality. In addition, to a great extent, (64%) the questionned SMEs estimate that their companies able to meet the requirements of foreign customers related to the warranty/service

requirements of foreign customers. Half of the companies (50%) consider to have the capacity to meet foreign customer' design/packing preferences, but only 22% of companies have built a brand on the international market, while 32% of companies reported that they have no interest to built a brand in foreign markets.

Table 4 *Regression analysis: product – the criterion of the export sales volume*

	Sum of squares	Degrees of freedom	Average square	F	Significance level	R	R2	Adjusted R-squared
Regression	6.953	4	1.738	4.693	.003	.543	.294	.232

Source: *authors' calculation*

The results of regression analysis which have included export sales volume as a criterion variable, and the characteristics of the product constitute a set of predictor variables, show that the model has proved as significant ($F = 4.693$, $p \leq .005$) having explained 23% of the variance (adjusted $R^2 = .232$) of the dependent variable (export sales volume) as shown in Table 4.

Table 5 *The characteristics of the product as a predictor of the export sales volume*

Predictors	Non-standardized coefficients		Standardized coefficients	t	Significance level
	B	Standard error	Beta		
Constant	.347	.498		.697	.489
Capacity to meet foreign customers' product quality	.556	.190	.416	2.925	.005
Capacity to meet foreign customer' design/packing preferences	-.131	.176	-.115	-.742	.462
Recognized brand on foreign markets	.199	.133	.211	1.501	.140
Capacity to meet warranty/ service requirements of foreign customers	.148	.167	.144	.885	.381

Source: *authors' calculation*

The capacity to meet foreign customers' product quality was found to be the only significant predictor ($\beta = .416$, $p \leq .005$). On the basis of the obtained

results (Table 5) we can conclude product quality greatly contributes to the export sales volume, while design, brand and warranty have not proved to be significant predictors of sales volume. SMEs consider that they have the capacity to meet the necessary quality of foreign customers' product quality which corresponds to results from findings (Žunić-Kovačević, Vapa-Tankosić, and Lazić, 2015; Zou, Fang and Zhao, 2003).

Table 6 *Regression analysis: product – the criterion of the export market share*

	Sum of squares	Degrees of freedom	Average square	F	Significance level	R	R^2	Adjusted R-squared
Regression	6.828	4	1.707	3.315	.018	.477	.228	.159

Source: *authors' calculation*

The results (Table 6) of regression analysis which have included export market share as a criterion variable, and the characteristics of the product constitute a set of predictor variables, show that the model has proved as significant ($F=3.315$, $p\leq.05$) having explained 15% of the variance (adjusted $R^2 = .159$) of the dependent variable (export market share).

Table 7 *The characteristics of the product as a predictor of the export market share*

Predictors	**Non-standardized coefficients**		**Standardized coefficients**	**t**	**Significance level**
	B	**Standard error**	**Beta**		
Constant	.528	.587		.900	.373
Capacity to meet foreign customers' product quality	**.656**	**.224**	**.436**	**2.927**	**.005**
Capacity to meet foreign customer' design/packing preferences	-.391	.208	-.306	-1.879	.067
Recognized brand on foreign markets	.061	.156	.057	.390	.698
Capacity to meet warranty/service requirements of foreign customers	.222	.197	.192	1.128	.265

Source: *authors' calculation*

The capacity to meet foreign customers' product quality was found to be the only significant predictor (β=.436, p≤.005). On the basis of the obtained results (Table 7) we can conclude product quality contributes to the export market share, while design, brand and warranty have not proved to be significant predictors of the export market share which corresponds to the findings that empirically proved positive link between the firm's relative superiority in cost, product, or service considerations and export performance (Murray, Gao and Kotabe, 2010; Piercy, Kaleka and Katsikeas, 1998).

Table 8 *Regression analysis: product – the criterion of export profitability*

	Sum of squares	Degrees of freedom	Average square	F	Significance level	R	R^2	Adjusted R-squared
Regression	3.707	4	.927	2.661	.045	.437	.191	.119

Source: *authors' calculation*

The results of regression analysis which have included export profitability as a criterion variable, and the characteristics of the product have constituted a set of predictor variables, show that the model has proved as significant (F=2.661, p≤.05) having explained 11.9% of the variance (adjusted R^2 = .119) of the dependent variable (export profitability).

Table 9 *The characteristics of the product as a predictor of the export profitability*

Predictors	**Non-standardized coefficients**		**Standardized coefficients**	**t**	**Significance level**
	B	**Standard error**	**Beta**		
Constant	1.048	.483		2.172	.035
Capacity to meet foreign customers' product quality	.289	.184	.239	1.567	.124
Capacity to meet foreign customer' design/packing preferences	-.080	.171	-.078	-.468	.642
Recognized brand on foreign markets	-.169	.128	-.197	-1.313	.196
Capacity to meet warranty/service requirements of foreign customers	**.346**	**.162**	**.372**	**2.136**	**.038**

Source: *authors' calculation*

The capacity to meet warranty/service requirements of foreign customers was found to be the only significant predictor (β=.372, p≤.05). On the basis of the obtained results (Table 9) we can conclude that the capacity to meet warranty/service requirements of foreign customers contributes to the export profitability, while capacity to meet foreign customers' product quality, design/packing preferences and brand have not proved to be significant predictors of the export profitability. That can be explained by an established relationship with the best distributors, prompt distribution process, an excellent follow up relationship and after sale support which corresponds with the findings that providing high levels of support are found to be positively related to export performance (Zou and Stan, 1998; Zou, Fang and Zhao, 2003).

Table 10 *Correlation between the product and the export performance*

	Export performance	
	Pearson correlation coefficient r	Significance level (p value)
Product	**.381**	**.006**

Source: *authors' calculation*

In the end, the results of correlation analysis indicate that there is a significant, moderate and positive link between the product and the export performance of companies (r=.381, p<..05).

Conclusion

The questioned SMEs estimate that they possess the necessary quality of export products, as they are able to meet the requirements of foreign customers related to the warranty/service, and capacity to meet foreign customer' design/packing preferences, but only a small percentage of SMEs have built a brand on the international markets, or intends to do it.

The research results indicate that the capacity to meet foreign customers' product quality influences export performance. This research generally confirms the literature but comes to some original conclusions, based on current problems of the Serbian SMEs. Although the SMEs from transition countries consider having good quality and competitively priced products they undoubtedly still have a lower presence on the international markets. Research findings (Vapa, Ignjatijević and Gardašević, 2015) indicate that Serbian enterprises that have the personnel qualified for export into foreign markets have the most effective impact on improving export performance, and that the most important problems in entering the foreign market,

especially the EU market, for the Serbian exporters are the complexity of export documentation, poor organization of the firm's export department, poor product design, high transportation costs, and inadequate promotion of enterprises on export markets.

This paper supports the previous literature findings which outline the need of further investigation of the determinants of firm export performance in order to develop appropriate SMEs export promotion policies for better positioning on international markets. Economies of Western Balkans countries, on the pathway to European integration shall depend on enhancing their efficiency and performances in industry, service and know-how. Modernizing production and raising efficiency and competitiveness, accelerating structural changes toward knowledge based services, are the major generators of value added, exports and new jobs (Vapa-Tankosić, Redžepagić and Stojsavljević, 2013).

In order to respond adequately to the demands of consumers, SMEs constantly need to innovate its products and services. However, new products and services are not only a result of technological innovation process, but also the impact of intangible resources of the company, as the basic factors for the application and transfer of knowledge. Exporters that continue to obtain productive effects by using knowledge to continuously improve the competitiveness and business performance as well as to adequately respond to the changing demands of consumers can introduce greater number of innovations in all segments. Innovation is one of the most important sources of export competitive advantage as innovative companies have been an important driver of international business.

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