



Innovation and survival of exporters: A contingency perspective



Ziliang Deng^a, Honglin Guo^{b,*}, Weifu Zhang^c, Chengqi Wang^d

^a School of Business, Renmin University of China, Haidian District, Beijing 100872, China

^b School of Economics, Renmin University of China, Haidian District, Beijing 100872, China

^c School of International Economics & Business, Nanjing University of Finance & Economics, Nanjing 210046, China

^d Nottingham University Business School, University of Nottingham, Jubilee Campus, Nottingham NG8 1BB, United Kingdom

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ABSTRACT

We challenge the traditional view that innovations always help exporters prosper in competitive international market, by developing and testing the premise that the relationship between innovation and export performance is contingent on some important firm-specific idiosyncrasies. With a large dataset of Chinese firms, the empirical results demonstrate that innovation could be detrimental to exporter survival. Such negative effect is more pronounced for firms that have weak profitability and high outstanding receivables, and also for those without foreign ownership. Nonetheless, we also observe a positive relationship between innovation and survival in highly profitable exporters. By identifying the negative rather than conventionally assumed positive effect of innovation, and the conditions under which innovation facilitates or impedes exporter survival, this paper contributes to the literature on the relationship between innovation and export in the context of emerging markets. Our findings have important implications for how managers develop innovation strategy to compete in the export market.

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1. Introduction

As export competition intensifies in the global market, policy makers in many countries, including China, are increasingly advocating technological innovation in order to enhance export competitiveness and upgrade export structure (Li, 2012). This is based on a belief that innovation enables exporters to maintain either a low cost structure via cost innovation or a high level of product differentiation, so that innovative exporters will be more able to survive competitive or adverse overseas conditions than other exporters. Despite being hugely important to both managers and public policy makers, there is almost no evidence to suggest whether innovation can really help exporters survive the increasingly fierce competition in the export market.

Prior research has examined the survival of innovative firms or products in a domestic market (e.g. Christensen, Suarez, & Utterback, 1998; Mitchell, 1994) and the effects of innovation on firms' exporting performance in terms of export propensity and intensity (e.g. Filatotchev, Liu, Buck, & Wright, 2009). While findings from these two streams of literature signal the academic value of looking into the relationship between innovation and

exporter survival, it is still unclear whether and under what conditions innovation promotes or impedes exporter survival for two reasons. First, as engaging in international businesses in geographically, culturally, and economically distant countries brings firms challenges that they do not often encounter in the domestic market, R&D efforts that prove to be successful in the domestic market do not necessarily receive commercial success in foreign markets (Deng, Jean, & Sinkovics, 2012). This is particularly true for firms that lack a strategic plan to carefully match their innovation strategies with internationalization objectives. Therefore, innovations that help firms survive domestic competition do not necessarily enable them to survive the export market. Second, a large portion of the prior work examines the effects of innovation on export performance measured by export intensity. These findings, however, hide a fact that a vast majority of export-oriented firms in the labor-intensive industries achieve export profit margins that are too thin to afford any external shocks (Besedeš & Prusa, 2011). More importantly, findings from this stream of research might be misleading as they implicitly assume that all exporters have survived the competition in the export market. As these studies have not included exporters that fail to survive the export market, they only provide a partial understanding of the relationship between innovation and export performance.

The paper aims to fill these research gaps. First, we examine whether innovation impacts the survival of emerging market exporters. These exporters typically do not possess strong

* Corresponding author. Tel.: +86 10 8250 9718; fax: +86 10 6251 1091.

E-mail addresses: Ziliang.Deng@ruc.edu.cn (Z. Deng), Honglin.Guo@yahoo.com (H. Guo), cwf-01@163.com (W. Zhang), Chengqi.Wang@nottingham.ac.uk (C. Wang).

technological innovations, but many of them perform well in the export market. This is an intriguing paradox that deserves academic attention. Second and more importantly, we investigate *how* innovation impacts the survival of emerging market exporters. We develop and test the theoretical hypotheses that the effects of innovation on exporter survival are not straightforward, but vary considerably among exporters contingent on three firm-specific idiosyncrasies, namely, their level of profitability, receivables and foreign ownership. By demonstrating whether and how innovation impacts the survival of exporters from emerging markets, we advance the literature concerning the relationship between innovation and export performance.

China offers an ideal setting for our research. Similar to the case of exporters in other emerging economies, cost leadership is still a source of international competitiveness for a majority of Chinese exporters (Zeng & Williamson, 2007). As the labor cost is inevitably rising as a consequence of rapid economic growth (Sousa & Poncet, 2011), Chinese exporters are increasingly striving to enhance technological innovations to defend their competitive position in the export market (Li, 2012). Therefore, both empirically and policy-wise, it is intriguing to investigate whether and how innovation helps Chinese firms survive the increasingly competitive export market.

2. Theoretical foundation

2.1. Innovation and survival

As technology has increasingly become a competitive arsenal, many firms compete through development of new technologies and products (e.g. Cefis & Marsili, 2006; Christensen et al., 1998; Helmers & Rogers, 2010; Mitchell, 1994). However, a number of factors make uncertain the relationship between innovation and survival. First, R&D is often a costly and highly risky effort, thus making the associated costs outweigh the benefits arising from such activities. Such “liability of innovativeness” increases the probability of firm death or new product failure (Audretsch, 1995; Bayus & Agarwal, 2007; Buddelmeyer, Jensen, & Webster, 2010; Sinha & Noble, 2008). Second, although one might expect that innovations enable a firm to survive competitive market, this cannot be easily achieved. Intense competition and rivals’ imitations increase the difficulties for firms to appropriate the fruits of innovation (Kafourous, Buckley, Sharp, & Wang, 2008). Further, the innovations of competitors may neutralize some of the gains arising from the firm’s own R&D investments (Deng et al., 2012), hampering the firm’s odds of surviving competition through innovation. Third, the value of innovation depends on the life cycle of the product (Vernon, 1966). Competitive pressures tend to be severe during the early stage of a product’s life cycle when massive entries and exits are observed in an industry (Jovanovic & MacDonald, 1994; Klepper, 1996). Hence, it can be disadvantageous to engage in costly innovative activities prematurely (Bayus & Agarwal, 2007). Only when the technological development has already well established can an entrepreneurial firm enjoy a higher survival rate through innovation, i.e. late-mover advantage (Agarwal & Audretsch, 2001; Åstebro & Michela, 2005; Cefis & Marsili, 2006; Christensen et al., 1998).

Furthermore, the relationship between innovation and survival of a firm or a new product also depends on a set of other contingency conditions. Thieme, Song, and Shin (2003), for example, find that new product projects can survive best only if managers have strong management skills and can obtain strong support from senior management. Similarly, the effects of innovation are conditional on marketing skills which complement the firm’s technological capabilities (Song, Droge, Hanvanich, & Calantone, 2005). In this vein, Giarratana and Fosfuri (2007) find

that successful innovators either offer a comprehensive product line, or the best quality in each product category, but generally do not offer both, as market selection wipes out firms that do not execute a clear and focused strategy. Furthermore, other firm-specific factors such as the degree of product diversification and firm age also matter. Wezel and van Witteloostuijn (2006) show that firms with a broad portfolio of products are more likely to survive than those with a narrow portfolio of products. Similarly, older and larger firms tend to observe a positive relationship between innovation and firm survival (Åstebro & Michela, 2005; Cefis & Marsili, 2006).

2.2. Survival and exit of exporters

Export *intensity* and exporter *survival* depict two different outcomes of a firm’s exporting activities. While export intensity takes into account only firms that stay in the export market, it excludes firms that exit the export market. There are two possible forms of exit from export. A firm either exits from international market only but is still active in domestic market, or the firm exits from both international and domestic markets simultaneously. Nevertheless, the literature reports a close relationship between exporter exit from foreign markets and firm failure. Evidence indicates that exiting from overseas markets makes exporters less exposed to international competition and knowledge pool, thus producing a negative effect on productivity and ultimately the success of the exporter (Aw, Chung, & Roberts, 2000; Girma, Greenaway, & Kneller, 2003; Yasar & Rejesus, 2005). Reinforcing this argument, research shows that the productivity differential between exporting and exiting plants widens after exporters exit the international market (Aw et al., 2000). Similarly, Ilmakunnas and Nurmi (2010) find that on average 49.3% of the plants that exit the export market also close down the entire firm in the same year. For all these reasons, the trade literature often interprets export market *exit* as export market *failure* (Bernard & Wagner, 2001; Chor & Manova, 2012; Ilmakunnas & Nurmi, 2010).

Finally although firms typically start internationalization with export before switching to more advanced stages of market entry, an exporter can strategically withdraw from export market for various reasons (Pauwels & Matthyssens, 2004). However, such an exit strategy may occur only in a trivial portion of exporters in export-oriented economies even if foreign direct investment (FDI) is a realistic option. Indeed, our data show that only a very small portion of exporters has conducted FDI. By the end of 2008, 3654 Chinese manufacturing firms had invested abroad (Ministry of Commerce of China, 2009), accounting for 2.1% only of the number of exporters in our sample. Furthermore, policy incentives offered by the Chinese government such as export duty rebates reduce the intention for Chinese exporters to withdraw from the export market or switch to FDI.

Recent advances in trade literature (e.g. Bustos, 2011; Costantini & Melitz, 2008; Helpman, Melitz, & Yeaple, 2004; Melitz, 2003) have highlighted the role of firm heterogeneity in determining survival and exit of exporters in international markets. It is argued that firm-specific factors such as quality of human resources, competitiveness of price, transportation costs, speed of collecting overseas payments and language communication may affect the survival of the exporter (Crick, 2002). For example, the ability of managers to perceive international risks may play an important role. Despite high uncertainty, some managers still proceed with export, simply due to a low awareness of the potential problems (Liesch, Welch, & Buckley, 2011). The literature on firm heterogeneity also suggests that entry into the export market is a self-selection process, indicating that more productive firms can afford the sunk costs, and therefore are more likely to survive in the export market than less productive firms.

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