# Product innovation breaks through export barriers

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## It seems that everyone agrees that small firms need to export to become big players. Bruno Cassiman et al. show that product innovation appears to be key.

As U.S. President Obama remarked at the annual Export-Import Bank conference in Washington, D.C., "Some of the biggest factors limiting a firm's decisions to export are the high upfront costs of establishing a foothold in a new market."

He then pledged $2 billion a year to support small- to medium-sized businesses seeking to operate in foreign markets.

Everyone is aware that exporting is important for firm growth and success, but it is a case of survival of the fittest, with only the most productive firms able to surmount barriers to export.

So what makes one company more productive than another? It used to be assumed that it was simply a matter of luck: productive firms thrive and expand, while unlucky and inefficient ones die. But luck doesn't explain how a firm's decisions can affect outcomes.

In the paper "Innovations, Exports and Productivity," published in the *International Journal of Industrial Organization*, IESE Prof. Bruno Cassiman along with Elena Golovko and Ester Martínez-Ros find that the decision to invest in product innovation reaps rewards. For small firms wondering what kind of investment would enhance the company's exporting future, these findings may be of interest.

## Innovate to accumulate

The authors start by reviewing studies showing that a firm's investment decisions affect its productivity and consequent ability to export. Since the ROI from exporting is part of what shows a firm to be productive, it feeds back to create a productivity circle.

However, studies show that R&D and innovation activities are linked to the firm's initial productivity. The authors, therefore, take a closer look at decisions related to this.

The authors reveal what specific kind of innovation leads to success in exporting. Previous research has shown, for example, that demand for a firm is more likely to explain superior productivity than technical efficiency.

Since product innovation affects the former, and process innovation the latter, the authors expected product innovation to be more important for firm success and entry into the export market.

## Relationship between innovation and exporting

To test this hypothesis, the researchers use data taken from the ESEE survey of Spanish manufacturing firms. The figures are based on companies of less than 200 employees between 1990 and 1998.

The sample fits the authors' purposes well, since there are hardly any firms with foreign investment, so other internationalization strategies don't get mixed up with exporting. What's more, Spain underwent the complete business cycle of boom, recession and recovery over the period studied, and due to its entry into the European Union, many firms were getting into the export market.

The authors first look at the association between innovation, export and productivity. They then study the direct relationship between innovation and exporting.

## Product innovation is key

As expected, innovators generally showed more productivity and export activity than non-innovators.

The difference in productivity between exporting product innovators and non-exporting product innovators wasn't that pronounced, suggesting that innovation itself is the moderating force. Firms focused on innovating their products all have about the same level of productivity, whether they sell abroad or not.

When relating type of innovation to export activity, the authors initially thought that product innovation, rather than process innovation, would win out. Only 8 percent of non-innovating firms start to export in a given year. They found that around 13 percent of product innovators jump the export hurdle, while only 11 percent of process innovators do.

So, while innovation generally increases the chance of switching to export, product innovation increases the chances of the average firm entering the export market by 49 percent. These exporting innovators are at the same time less likely to withdraw from exporting than their process innovator counterparts.

This study has important policy implications for firms. Rather than spend money on promoting existing products, companies should branch out and create new ones if they want to get into export. Perhaps the billions of dollars being pledged to push exports would be better spent on promoting greater innovation instead.

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