The importance of Internationalization strategy for Innovation in Portuguese firms

Mónica Azevedo[1], Carla Azevedo Lobo[2], Carla Santos Pereira[3], Natércia Durão[3] e Isabel Maldonado[2]

[1]Universidade Portucalense; REMIT- Research on Economics, Management and Information Technologies;

[2]Universidade Portucalense; REMIT- Research on Economics, Management and Information Technologies; IJP- Instituto Jurídico Portucalense, Porto, Portugal; GOVCOPP, Aveiro, Portugal

[3]Universidade Portucalense; REMIT- Research on Economics, Management and Information Technologies; IJP- Instituto Jurídico Portucalense, Porto, Portugal

monicaa@upt.pt

cadsa@upt.pt

carlasantos@upt.pt

natercia@upt.pt

ianm@upt.pt

Abstract

Innovation and internationalization seem to be vital strategies for the survival and growth of companies facing an increasingly competitive global environment. The two-way link between these two factors has become a topic of interest among researchers. Although innovation and internationalization are highly related activities, the role played by innovation in the internationalization process of firms has been analysed by two streams of literature: while some authors state that innovation assists companies' internationalization, others consider that innovation can be a consequence of internationalization process. Given the great importance of small and medium-sized enterprises (SMEs) for the growth of economies, part of literature has paid special attention to this kind of enterprises. The aim of this study is to explore the relationship between innovation and internationalization within Portuguese firms, in particular to analyse whether Portuguese entrepreneurs consider innovation as an important factor in the process of internationalisation. To achieve this goals, we will use descriptive and inferential data analysis techniques.

Keywords: Internationalization, Innovation, SMEs

JEL classifications: D22, F13, H32, L25, L26, M16

Introduction

The development of the business world has been breaking all boundaries, being the increasing internationalization of companies taken for granted regardless of size, age,

international or domestic experience, slightly contradicting the traditional theories of internationalization. Companies need to find new ways to develop competitive advantages which comprises seeking and acquiring new skills, resources and capabilities. Several are the traditional theories that focus attention on the determining factors in the internationalization process. Sapienza, Autio, George and Zahra (2006) argue that companies have to continually adapt to the dynamic changes in the environment so the innovation process is fundamental and product innovation is essential. According to Lobo, Fernandes, Ferreira and Peris-Ortiz (2019), SMEs face specific challenges such as a lack of human, financial, technological and informational resources. The importance of innovation seems to increase in a global market context. Zucchella and Siano (2014) underline that innovative resources and capabilities are essential for firms' growth in both domestic and foreign markets. Genc, Dayan and Genc (2019) and Saridakis, Idris, Hansen and Dana (2019) address the product life cycle: on the one hand, to stress that as these cycles are getting shorter, it is imperative that companies continually explore new products (or services) to offer; on the other hand, Vernon's Product Life Cycle Theory is mentioned in order to link innovation and internationalisation. Additionally, it seems to be consensual that internationalization and R&D investment / innovation are two important strategic decisions related to the success of firms (Chang, Chang, Hsu and Yang, 2018; Gjergji, Lazzarotti, Visconti and Saha, 2019). Moreover, their joint effect is considered vital for companies' success and survival in the global markets (Onetti, Zucchella, Jones and McDougall-Covin, 2012). This relationship is even described as a dynamic virtuous circle given that internationalization and innovation reinforce each other (Golovko and Valentini, 2011).

Therefore, it's our intention to investigate the influence of internationalization on innovation, in particular to analyse whether Portuguese entrepreneurs consider innovation as an important factor or a motivation in the process of internationalization.

Literature Review

Several are the traditional theories that focus attention on the determining factors in the internationalization process. Sapienza et al. (2006) argue that companies have to continually adapt to the dynamic changes in the environment so the innovation process

is fundamental and product innovation is essential. According to Lobo et al. (2019), SMEs face specific challenges such as a lack of human, financial, technological and informational resources. Czinkota et al. (1999) provide a list of key factors that influence the strategic approach to business internationalisation. These factors are grouped into proactive factors (potential advantages in terms of profits, technology, unique products, information management, tax benefits and economies of scale) and reactive factors (competitive pressure, excess capacity, saturation of the domestic market and proximity to customers). Mathews (2006) argues that companies might internationalise for relational motives (by responding to competitors, following up on customers' internationalisation processes or acting upon approaches of foreign companies), access to foreign resources (finding lower production costs abroad or accessing technological knowledge through branches) or government incentives (through the support of the home or host government). Also, as reported by Dunning and Lundan (2008), internationalization has four motivations, including Resource-seeking, which defines a search for resources, such as raw material, labour and obtaining technological, management or marketing know-how, which given the scarcity or non-existence in the country of origin, lead to a need for investment in foreign countries. And Strategic asset-seeking, where MNEs constantly seek to exploit gains from market imperfections, or originate them for their own benefit. To do so, acquiring physical goods, specialized labour, know-how, in R&D, through mergers or joint ventures, in order to achieve long-term goals.

Empirical and theoretical research have underlined the importance of innovation for the survival and growth of firms (*e.g.* Audretsch, Coad and Segarra, 2014; Baumol, 2002; Cefis and Marsili, 2006; Schumpeter, 1942; Zucchella and Siano, 2014). Within this framework Schumpeter's work is considered pioneer in recognizing innovation as fundamental for the growth and survival of firms competing in the market (Audretsch et al., 2014; Cefis and Marsili, 2006). By allowing cost reduction and/or product differentiation, innovation can be an important tool for the competitiveness of companies, ensuring them a competitive advantage (Genc et al., 2019). Furthermore, Zucchella and Siano (2014) stress that the creation and development of SMEs are commonly based on innovations.

In this discussion, the distinction between different types of innovation cannot be left out. Schumpeter (1934) proposed five types of innovations: product innovation, process innovation, market innovation, input innovation and organizational innovation. OECD (2005) consider the following types of innovation: product innovation, process innovation, marketing innovation and organisational innovation. The success of firms can differ according to innovation type. Heunks (1998), for example, concludes that any kind of innovation contributes to small firms' growth but only process innovation increases their productivity. However, the author underlines that profits tend to be low in innovating small firms due to the price of innovative investments and/or because that was the main reason for innovation. For medium enterprises the results found by Heunks (1998) for the relation between innovation types and firms success are not statistically significant (at 0.05 level). Moreover, his study shows that medium-sized firms exhibit higher levels of all types of innovation than small firms which can be pointed as an explanation for why only in small enterprises success depends on innovation. Also the classification of innovations as to the degree of novelty should be considered: incremental *vs.* radical. An incremental innovation refers to an innovation with low level of novelty while an innovation is considered radical when it comprises a high level of novelty. Furthermore, radical innovations imply big changes (correspond to something completely new) and incremental innovations are related to a process of continuously improvement, for example, step-by-step improvements of existing products (Eiriz, Faria and Barbosa, 2013; Sarkar, 2014; Tidd et al., 2018). Thus, radical innovations can be associated with the Schumpeterian term of 'creative destruction', that is, from Schumpeter's original view incremental innovation does not exist (Schumpeter, 1934, 1942). The contribution of innovations to firms' growth can be different if strategies are based on radical or incremental innovations (*e.g*. Eiriz et al., 2013).

In a global market context, innovation seems to be increasingly important. Innovative resources and capabilities are considered essential for firms' growth in both domestic and foreign markets (Zucchella and Siano, 2014). Analysing the product life cycle can help to understand the importance of innovation for business performance: on the one hand, as these cycles are getting shorter, it is imperative that companies continually

explore new products (or services) to offer; on the other hand, according to Vernon's Product Life Cycle Theory, firms' internationalization process is related to the product life cycle (Genc et al., 2019; Saridakis et al., 2019). Furthermore, there is broad consensus among the researchers that internationalization and R&D investment / innovation are two key strategic decisions to the success of firms (Chang et al., 2018; Gjergji et al., 2019). In addition, the combined effect of innovation and internationalization is viewed as a driving force of companies' success and survival in the global markets (Onetti et al., 2012). The relationship between these two factors is even described as a dynamic virtuous circle given that internationalization and innovation are mutually reinforcing (Golovko and Valentini, 2011).

Studies about the link between innovation and internationalization are relatively recent. Additionally, although most studies examine large multinationals, a stream of literature has analysed the relationship between innovation and internationalization with a special focus in SMEs. In particular, the innovation contribution to SMEs internationalization process has been arousing the interest of researchers in recent years (Saridakis et al., 2019). However, the innovation–internationalisation link is not a straightforward issue and the referred relationship is not a matter of consensus among researchers. If, on the one hand, internationalization can be considered in itself a process of innovation and it allows the access to diverse sources of knowledge stimulating innovation, on the other hand, the development of innovations can create or improve market opportunities (Zucchella and Siano, 2014). Some of published studies focus on the impact of innovation on companies' internationalization while other address the reverse causality and in each case can be discussed if there is a direct or an indirect influence. There are also works that explore a bidirectional link and/or the complementary effect of the two for example on firm's growth (Gjergji et al., 2019). According to Genc et al. (2019) most of the existing research about this relationship examine the influence of innovation on internationalization and only few studies investigates the opposite impact. Recent studies (e.g. Genc et al., 2019 and Saridakis et al., 2019) emphasize the lack of consensus among the literature that have studied this relationship, namely the effect of innovation on internationalization, given that empirical studies present mixed results about this relationship: they find a positive, negative or even a not significant effect between these

two factors. The arguments pointed out as justification for the different results found include the industry context, the innovation measurement, especially when the focus are the SMEs, and how the studies address the type of innovation. Gjergji et al. (2019) present the main empirical findings about the relationship between internationalization and innovation distinguishing the different branches of research that have addressed this relationship. They point out that the most investigated are the influence of innovation on internationalization and the reverse direction of the relationship. Nevertheless, regarding the sign of the relationship the authors conclude that there is a broad consensus among researchers with respect to the positive impact of innovation on internationalization but the results on the reverse causal effect are controversial. Empirical studies on innovation-internationalization reciprocal causal relationship find a positive sign for the relationship. Evidence on innovation-internationalization complementarity and simultaneity impact on firm's performance and/or growth also shows a positive sign. An important note is that most of the studies analysed measure internationalisation through exports (in particular, export propensity).

As previously mention, some researchers study how innovation contributes to internationalization. Focusing on SMEs in the textile and clothing industry in the Campania Region (Italy), Zucchella and Siano (2014) analyse the role played by innovation in driving export performance. Meliá, Pérez and Dobón (2010) investigate the influence of innovation orientation on the internationalization of Spanish SMEs within the service sector concluding that an innovative orientation contributes for an early foreign market entry and allows them to choose higher-control entry modes. Williams and Shaw (2011) discuss the innovation – internationalization relationship in tourism sector, emphasizing, for instance, that successful internationalization requires innovation. Using data from SMEs in the United Kingdom, Saridakis et al. (2019) study the role of innovation on SMEs internationalization paying special attention to innovation's degree of novelty and the different types of innovation. They find that although innovative SMEs are more likely to internationalise than non-innovative ones, the results differs according to the type of innovation (for example, the propensity to export is higher in case of goods innovation than in case of service or process innovation) and the degree of novelty of innovation (for example, radical innovations or the

combination of radical and incremental innovations have a higher effect on the probability of SMEs exporting than incremental innovations).

On the other hand, another set of studies investigate the influence of internationalization on innovation. For example, Boermans and Roelfsema (2015) examine how various internationalization modes affect innovation in ten Eastern European and Central Asian transition economies and Abubakar, Hand, Smallbone and Saridakis (2019) investigate the influence of internationalization modes on SME innovation in Sub-Saharan least developed countries. Chang et al. (2018) and Genc et al. (2019), for instance, analyse the impact of internationalization on innovation considering multinational enterprises and SMEs, respectively. The latter conclude that, in general, there is a positive impact of internationalization on innovation and demonstrate that this impact is indirect through market orientation and entrepreneurial orientation, which are considered by the authors as key factors to internationalized SMEs obtain better innovation performance. Using a sample of 2420 Spanish private firms, Gjergji et al. (2019) find not only a positive effect of the level of exports on the number of innovative products of firm but also a positive impact of family management on innovation, underlining that family firms have particular characteristics that can boost the impact of internationalization on innovation.

Additionally, other authors, such as Bagheri, Mitchelmore, Bamiatzi and Nikolopoulos (2019) and Golovko and Valentini (2011), highlight the importance of combining innovation and international activities.

Notwithstanding, it seems to be consensual that one of the advantages providing by internationalization is the access to/acquisition of new resources (Bagheri et al., 2018; Genc et al., 2019; Saridakis et al., 2019). Aiming to corroborate the positive influence of internationalization on innovation, Gjergji et al. (2019) underline the importance of the resources acquired and developed during the internationalization process, in particular, the access to new technological know-how and knowledge achieved from new alliances (resulting from interaction with foreign partners). Thus, the authors believe that exporting firms can acquire and develop resources and skills which are essential for innovation.

SMEs often lack resources and capabilities (Bagheri et al., 2018; Genc et al., 2019). Consequently, it may be difficult to invest in research departments (Sarkar, 2014). In this context, sharing innovation activities can be essential and partnerships developed in international market can play an important role.

Methodology

Aiming to explore the relationship between innovation and internationalization within Portuguese firms, in particular to analyse whether Portuguese entrepreneurs consider innovation as an important factor in the process of internationalization, an online questionnaire survey was conducted with several variables, based on the literature review. The questionnaire was sent to all companies registered in the AICEP database of Portuguese internationalized firms, by sending a link via e-mail and using the Google Forms tool between May 2019 and January 2020.

Data collected from the 238 valid responses (Portuguese internationalized firms) were treated by IBM SPSS Statistics 26.0 software through a quantitative approach based on descriptive and inferential analysis.

This 238 Portuguese firms are from different sectors (mostly firms are from sectors Manufacturing industries / Wholesale and retail trade; car and motorcycle repair / Consulting, scientific, technical and similar activities) and different sizes. In terms of size: 36.1% are micro firms (< 10 persons), 40.3% small (10-50 persons),17.6% medium (50-250 persons) and the remaining are large firms (>250 persons) [1].

The various determining factors of internationalization referred to as External Market Characteristics have been classified on a 5-Likert point scale: "1-not important", "2-not very important", "3-important", "4-very important" and "5-extremely important" and two more options (term unknown and not applicable (NA)). It should be noted that the most important factor is "Favourable perspectives of growth in a new market" with an average of 3.86 (median 4), followed by "Follow up customers" with an average of 3.57 (median 4), so they are considered as very important factors. Considered as important

[1] Classification according to Commission Recommendation of 6 May 2003 available at https://eur-lex.europa.eu/legal-content/PT/ALL/?uri=CELEX%3A32003H0361

factors are "Follow partners" (average 3.11, median 3), "Allow access to new technologies or resources" (average 2.70, median 3) and "Weak competition in the market" (average 2.68, median 3). It should also be noted that the "Follow competitors" factor is considered to be of little importance (average 2.57, median 2). We can see some of these results in Figure 1.

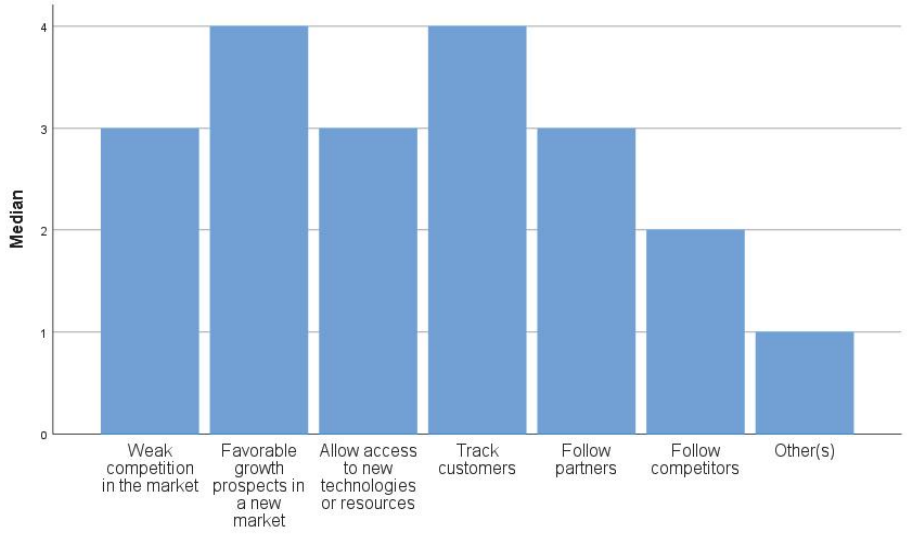

Figure 1- Median of the factors (characteristics of external market)

It should be noted that among all the factors mentioned above, "Allow access to new technologies or resources" is the factor that characterises innovation that drives the internationalisation of Portuguese companies, with 83.5% of respondents to the questionnaire considering it to be at least important. Since 94% of the firms that answered the questionnaire are micro firms or small/medium firms, we decided to consider only these two groups, thus having a sample of 224 firms. Analysing now the possibility of differences in the degrees of importance attributed to the factors determining the characteristics of the external market (depending on the size of the firm and/or the sector) we carried out non-parametric tests.

After applying the Mann-Whitney test, we can conclude that there are no significant differences between the size of the firm (Micro/SMEs) versus the factor "Allow access to new technologies or resources" (p-value=0.419>0.05). In a final remark, the size of the company in which the respondents are included does not influence the importance that they attach to the factor characterizing innovation.

Regarding the sector in which the companies operate, we found that out of the 238 companies in the sample the majority (199 companies corresponding to 83.6% of the total) belong to one of the 3 sectors: (A) Manufacturing industries (124), (B) Wholesale and retail trade; car and motorcycle repair (51) and (C) Consulting, scientific, technical and similar activities (24). Therefore, we now work with the recoded sector variable in these 3 categories (setor_rec). Figure 2 presents the median for the several Factors of External Market by sector.

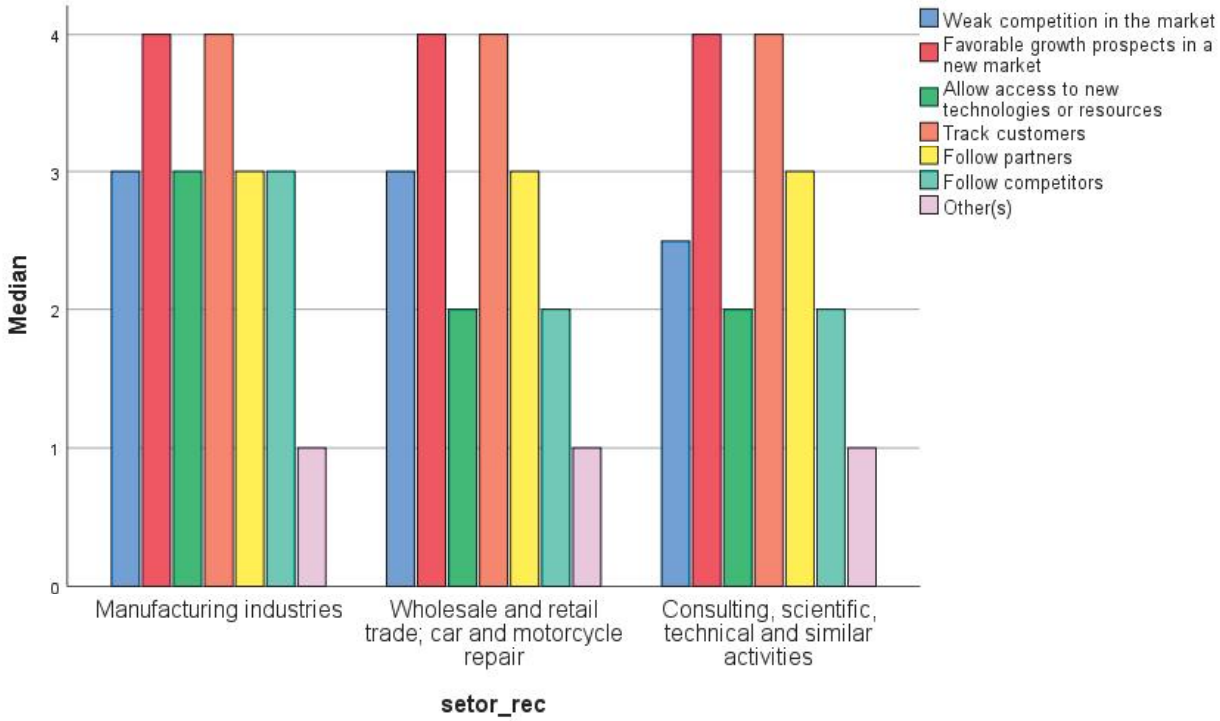

Figure 2- Median of external market factors by sector

The Kruskal Wallis test, allows us to conclude at a level of significance of 10%, that are significant differences between the sector of the firm versus the factor "Allow access to new technologies or resources" (p-value=0.08<0.10). However, this test does not allow us to conclude which sectors are different from the others. Therefore, for this identification, we proceeded with multiple comparison tests.

Multiple Comparisons

Dependent Variable: Rank of Fator

LSD

(I) setor_rec	(J) setor_rec	Mean Difference (I-J)	Std. Error	Sig.	95% Confidence Interval Lower Bound	95% Confidence Interval Upper Bound
Manufacturing industries	Wholesale and retail trade; car and motorcycle repair	23,087761*	11,056356	**,038**	1,28307	44,89246
	Consulting, scientific, technical and similar activities	18,786290	14,821881	,206	-10,44455	48,01713
Wholesale and retail trade; car and motorcycle repair	Manufacturing industries	-23,087761*	11,056356	**,038**	-44,89246	-1,28307
	Consulting, scientific, technical and similar activities	-4,301471	16,452384	,794	-36,74790	28,14495
Consulting, scientific, technical and similar activities	Manufacturing industries	-18,786290	14,821881	,206	-48,01713	10,44455
	Wholesale and retail trade; car and motorcycle repair	4,301471	16,452384	,794	-28,14495	36,74790

*. The mean difference is significant at the 0.05 level.

Table 1- Multiple comparisons between sector and factor “Allow access to new technologies or resources”

Analysing the output of multiple comparisons (Table 1) it is then possible to conclude that for a significance level of 5%, the statistically significant differences in the degrees of importance assigned to the factor "Allow access to new technologies or resources" occur between sectors (B)-Wholesale and retail trade; car and motorcycle repair and (A)-Manufacturing industries (p-value=0.038).

Manufacturing industries attach a greater degree of importance to this factor that characterizes innovation. This is because 63.7% of these industries consider this factor

at least important, while in the Wholesale and retail trade; car and motorcycle repair this percentage drops to 49%. Moreover, 51% of the industries in the latter sector consider the innovation factor to be of little or no importance (see Table 2). Finally, more detailed information that better visualises the behaviour of the factor "Allow access to new technologies or resources" in the three most highlighted sectors in the study can also be seen in Figure 3.

			Manufacturing industries (A)	Wholesale and retail trade; car and motorcycle repair (B)
Allow access to new technologies or resources	Not important	Count	18	12
		% within setor_rec	14,5%	**23,5%**
	Not very important	Count	27	14
		% within setor_rec	21,8%	**27,5%**
	Important	Count	44	17
		% within setor_rec	**35,5%**	33,3%
	Very important	Count	29	7
		% within setor_rec	**23,4%**	13,7%
	Extremaly important	Count	6	1
		% within setor_rec	**4,8%**	2,0%
Total		Count	124	51
		% within setor_rec	100,0%	100,0%

Table 2- Contingency table between factor “Allow access to new technologies or resources and sectors (A) and (B)”

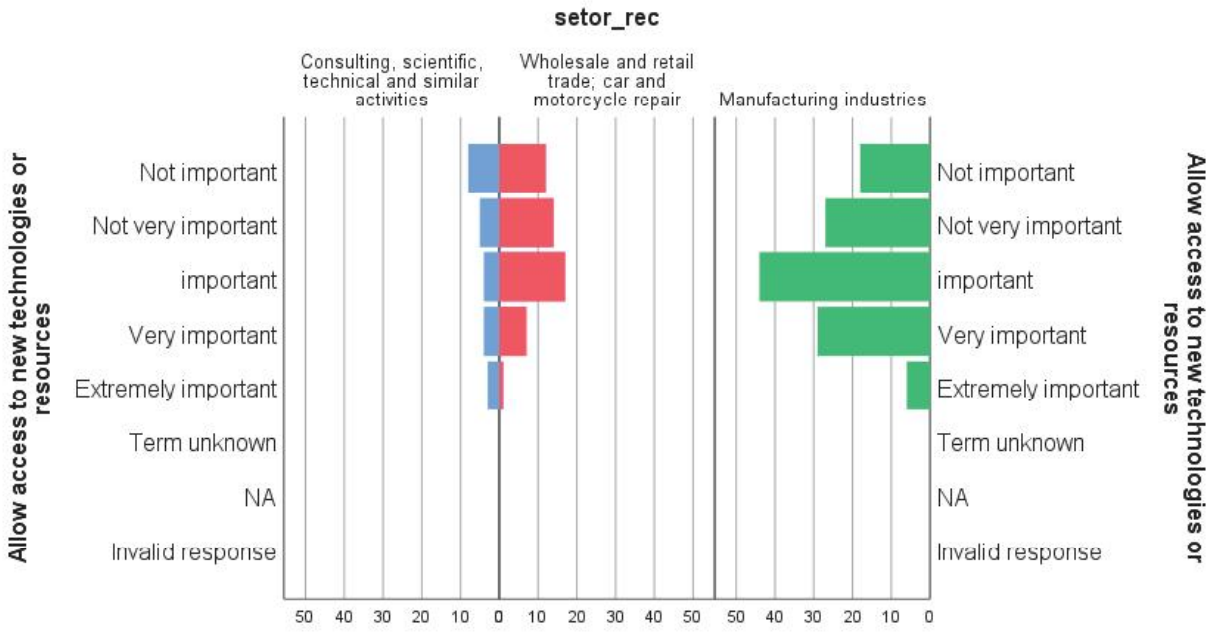

Figure 3- Pyramid count of factor ""Allow access to new technologies or resources" by sector.

Conclusion

This study explores the relationship between innovation and internationalization within Micro/SMEs Portuguese firms, in particular it analyses whether Portuguese entrepreneurs consider innovation as an important factor in the process of internationalisation. To achieve these goals, a sample of 224 micro firms or small/medium firms was used and descriptive and inferential data analysis techniques were applied.

Consistent with the literature, the results show that Portuguese entrepreneurs (Micro/SMEs) consider innovation as an important factor in the process of internationalisation.

In particular, the findings reveals that "Allow access to new technologies or resources" is the third most important factor (of those specified as characteristics of the external market) after "Favourable perspectives of growth in a new market" and "Track customers". Focusing on that factor that characterises innovation, "Allow access to new

technologies or resources", it is important to underline that 83.5% of respondents to the questionnaire considering it to be at least important.

Moreover, considering different firm sizes it is possible to conclude that there are no significant differences regarding the factor "Allow access to new technologies or resources", which means that the size of the company in which the respondents are included does not influence the importance that they attach to the factor characterizing innovation.

When differentiating according to sectors in which the companies operate, and considering the three sectors present in the sample ((A) Manufacturing industries (124), (B) Wholesale and retail trade; car and motorcycle repair (51) and (C) Consulting, scientific, technical and similar activities (24)), this study suggests that there are statistically significant differences in the degrees of importance assigned to the factor "Allow access to new technologies or resources" for sectors (B)-Wholesale and retail trade; car and motorcycle repair and (A)-Manufacturing industries (p-value=0.038). Manufacturing industries attach a greater degree of importance to this factor that characterizes innovation.

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