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MASTER’S THESIS

THE MEDIATION EFFECT OF INNOVATION ON THE
RELATIONSHIP BETWEEN
INTERNATIONALIZATION AND FIRM
PERFORMANCE

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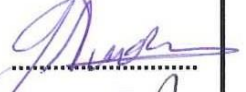
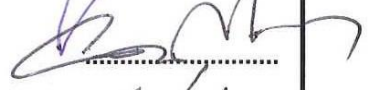
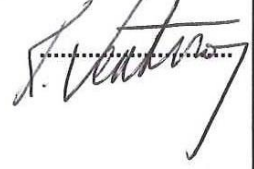
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DECLARATION

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Ayça Kübra HIZARCI

ABSTRACT

Master's Thesis

The Mediation Effect of Innovation on the Relationship between Internationalization and Firm Performance

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Cutting-edge technology transformed the world markets into a place where harbors a never ending fierce competition amongst the giant rivals. Although internationalization is a host of vast opportunities and high returns, challenges will present themselves. Firms undergo a number of organizational changes in order to adapt to each country's market they enter. During this process, they face many inconsistencies. Firms can overcome the challenges faced in international markets through strategic orientations and some specific capabilities, resources, and then meet their targeted performance outcomes.

In this complex and fast-changing environment, organizations must be capable of learning and flexible in response to any unforeseen threats, unpredictable changes and opportunities. In addition to those requirements, they are bound to offer better products and services by their unique competitive advantages.

Entrepreneurial orientation and organizational learning have a crucial role in firms' internationalization since they are considered as the drivers of firms into the international arena. Those two factors affect an organization's path to internationalize. On the other hand, innovation activities' importance cannot be undermined. Innovation is viewed as the solution for a sustainable competitive position in the international arena.

The focal point of this study is to examine the mediation effect of innovation on the relationship between internationalization and business

performance. Besides, the interrelations between entrepreneurial orientation, organizational learning, internationalization, innovation and firm performance were scrutinized through the application on 81 exporting firms operating in machinery, chemical, food and textile industry. The results put down to the fact that innovation partially mediates the relationship between internationalization and firm performance. In addition, having an entrepreneurial and learning flair drives firms to internationalize. However, the effect of learning is not as strong as entrepreneurial orientation. Lastly, there is a correlation between entrepreneurial orientation and organizational learning.

Keywords: Entrepreneurial Orientation, Organizational Learning, Internationalization, Innovation, Firm Performance

ÖZET

Yüksek Lisans Tezi

Ayça Kübra HIZARCI

**Yeniliğin Uluslararasılaşma ve Firma Performansı Arasındaki İlişkide
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İleri derecede gelişmiş teknoloji, dünya marketlerini; dev rakiplerle sonu olmayan çetin bir rekabete ev sahipliği yapan bir yer haline dönüştürdü. Uluslararasılaşma bir çok fırsatlar ve karlı getiriler sunmasına rağmen, bir çok zorluğu da beraberinde getirmektedir. Firmalar girdikleri her yeni pazara uyum sağlamak için çeşitli örgütsel değişimler yaşarlar. Bu süre boyunca bir çok iniş çıkışlar yaşarlar. Firmalar pazarlarda karşılaştıkları zorlukları, bazı stratejik yönelimler, özel yetenekler ve kaynaklar yoluyla aşarak hedeflenen firma performansına ulaşabilirler.

Kompleks ve sürekli değişen çevrede, öngörülemeyen tehditlere, beklenmeyen ani değişikliklere ve fırsatlara anında karşılık vermek için örgütler öğrenme ve esneklik yetilerine sahip olmalıdırlar. Buna ek olarak, firmalar sahip oldukları rekabet avantajlarıyla daha iyi bir hizmet veya ürün sunmak zorundadırlar.

Girişimcilik yönelimi ve örgütsel öğrenmenin uluslararasılaşmayı tetikleyen iki faktör olduğu ve firmaların uluslararasılaşmasında önemli bir rol oynadığı düşünülmektedir. Öte yandan, yenilik faaliyetlerinin önemi göz ardı edilemez. Yeniliğin, uluslararası pazarlarda firmaların sürdürülebilir rekabetçi pozisyonları için gerekli bir çözüm olduğu düşünülmektedir.

Tekstil, gıda, makine ve kimya sektöründe faaliyet gösteren 81 firma üzerine yapılan bu çalışmada, girişimcilik eğilimi, örgütsel öğrenme, uluslararasılaşma, yenilik ve firma performansı arasındaki ilişkiler

incelenmiştir. Sonuçlar yeniliğin, uluslararasılaşma ve firma performansı arasındaki ilişkiye kısmi olarak aracılık ettiğini ortaya koymuştur. Ayrıca, girişimcilik eğilimi ve örgütsel öğrenmenin de uluslararasılaşmayı etkilediği sonucuna varılmıştır. Fakat, öğrenmenin etkisi girişimcilik kadar güçlü değildir. Son olarak, girişimcilik ve örgütsel öğrenme arasında da bir ilişki olduğu sonucuna varılmıştır.

Anahtar Kelimeler: Girişimcilik Yönelimi, Örgütsel Öğrenme, Uluslararasılaşma, Yenilik, Firma Performansı

THE MEDIATION EFFECT OF INNOVATION ON THE RELATIONSHIP BETWEEN INTERNATIONALIZATION AND FIRM PERFORMANCE

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ABBREVIATIONS

AGFI	Adjusted Goodness of Fit
EO	Entrepreneurial Orientation
EU	European Union
CFA	Confirmatory Factor Analysis
CFI	Comparative Fit Index
FDI	Foreign Direct Investment
NAFTA	North American Free Trade Agreement
NFI	Normed Fit Index
OECD	Organization for Economic Cooperation and Development
OL	Organizational Learning
R&D	Research and Development
RMSEA	Root Mean Square Error of Approximation
SEM	Structural Equation Modeling

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INTRODUCTION

Through the ongoing revolutions in technology, the world became a place with full of interesting changes and challenges. Even the wealthiest firms can have trouble with keeping pace with those modifications. The revolution in technology keeps changing the rules of the game every day. Firms are subject to adapt themselves to those changes. One of the results of the technology is the mobility of resources most important ones of which are the knowledge and mobility of human and raw materials. The mobility of resources resulted in internationalization of firms. In international markets, knowledge is considered as the converter of uncertainty into risk. Through some special characteristics firms are able to take advantage of risk when it comes to survive.

In a technology-driven market, knowledge, technological skills and capabilities are the most powerful weapons used against the rivals. Today, what every organization has in common that they owe their superior performance to innovation. Firms increase the quality of daily life of people, through what and how they deliver the goods and services. Those innovation investments not only boost an individual enterprises performance but also the national growth.

Entrepreneurial orientation and organizational learning are the engines of a company that drive firms to make more commitments in international markets. Those are some of the special characteristics that a domestic firm may lack. The enthusiasm of making more further movements and willingness to become the best make firms more international. As learning boost the knowledge which is the best solution for overcoming uncertainties drives firms to perceive risky operations as tolerable.

In the light of the literature, this study focuses on the interplay between internationalization, entrepreneurial orientation, organizational learning, innovation and firm performance. This study is applied on the exporting firms operating in machinery, food, chemical, textile sectors. Those sectors are chosen in order to analyze the innovation intensity levels and their reflection to the performance in international markets.

In the coming chapters, each variable are explained in detail. The conceptual framework and hypotheses are set with the supports from the literature. After the research methodology, conclusion is made according to the findings.

CHAPTER ONE

INTERNATIONALIZATION

1.1. DEFINITION OF INTERNATIONALIZATION

After the Second World War, the efforts made for the destruction of the trade barriers between countries created a common world market which is borderless and allows the free movement of goods and services provided by firms regardless of their nationality. As the initially socialist countries underwent a restructuring process of their economy and opened their doors to the Western countries, companies started to realize the opportunities lying in the markets outside their home market. This dynamic growth of awareness in developing countries triggered the establishment of regional and international trade agreements. Also the institutions that provide a better environment for this free trade environment (Axinn and Matthyssens, 2002: 437). European Union (EU), North America Free Trade Agreement (NAFTA), Association of Southeast Asian Nations (ASEAN) are the best examples among those agreements and also the World Trade Organization called previously General Agreement on Tariffs and Trade (GATT) plays a vital role not only in lowering the trade barriers but also controlling those operations of firms.

The free trade made firms realize the advantages and opportunities of operating in distant markets. They examined the missing resource sides of countries and turned those imperfections into opportunities by combining their skills, knowledge and resources with the advantages in those markets such as cheap labor or raw materials. This development in the world market created a fierce competition in the world and by the same token, firms started to compete in a global arena where harbors more technology, skill, and knowledge intensive competition. Under this pressure of competitiveness, firms seek new markets and develop new strategies and unique competencies to enjoy the advantages of globalization. All those factors are changing the rule of the game every day, as the development of technology and knowledge have no end. Countless number of firms spread around the world in the hope of making high levels of profit through creating valuable products and services for customers. Through internationalization, firms achieve economies of scale and

scope. Besides, during the process they operate, they access to vital resources and gain intellectual assets.

Internationality refers to the state of a firm existing or operating in across markets (Pap and Chiang, 2008: 12). Kindleberger (1969) defines the term international as "the state a firm adopts toward outward operations or the business operations conducted abroad". Internationalization as a phenomenon has been an important issue for firms competing in international business environment, which is described by Welch and Lounsbury (1988: 34) as "the process through which firms increase carrying out their international operations across borders". In this process the firm develops itself gradually in different stages with different level of resource commitments (Melin, 1992: 103) and boosts its financial performance (Lu and Beamish, 2001: 582). In each stage, the firm gains experience and knowledge which are used for further commitments and help the firm's adaptability to different environments. Thus, internationalization is also defined as "the consequences of incremental decisions and adjustments made by the firm for its growth" (Johanson and Vahlne, 1977: 23). Those decisions can be in terms of for example; market entry modes, the amount of resources to be committed and the marketing strategies (Axinn and Matthysens, 2002: 436). However, there are some exceptional firms that do not expand its operations sequentially, instead they start to operate in foreign markets without any home market experience, which are called the Born Globals.

In the literature, the internationalization strategy is interpreted in two perspectives which are depth and breadth of internationalization (Hsu and Boggs, 2003: 27). Those terms present a snapshot of the firm's overseas operations (Kuivalainen et al., 2007: 255). The depth of internationalization refers to what extent a firm involves in overseas operations whereas the breadth of internationalization represents to what extent the firm has dispersed its operations across markets (Goerzen and Beamish, 2003).

1.2. A REVIEW OF THEORIES OF INTERNATIONALIZATION

Internationalization theories can be analyzed in two aspects. The macro aspect considers internationalization at the country level whereas the micro aspect focuses on the firm level internationalization.

1.2.1. Macro Aspect of Internationalization

The macro aspect theories of internationalization focus on the internationalization of countries.

1.2.1.1. Mercantilism

Internationalization has its roots that date back to the emergence of the Mercantilism Movement in which it is emphasized that the nations' wealth can only be improved through increasing the exports and lowering the level of imports. Those exports would be achieved through the resource endowments of the countries. The Mercantile System coined by the Adam Smith aims to boost the economy of the nation and build a powerful nation among its competitors in the region (Lahaye, 2008).

1.2.1.2. Absolute Advantage Theory

Mercantilism led the emergence of the idea that each country has some specific advantages in terms of resources such as natural, labor and land, over the others that make them superior to others which refers to the theory called Absolute Advantage Theory developed by Adam Smith (Myint, 1977: 232). According to this theory, if each country specializes on what they produce more efficiently than others, and sell it to the ones who cannot produce like them, they will have the absolute advantage over the others (Myint, 1977: 233). As a result, there will be exchange of products and services between different country markets (Hill, 2008: 121).

1.2.2. Micro Aspect of Internationalization

In contrast to the macro level of internationalization theories, the micro aspect focuses on the firm level of internationalization.

1.2.2.1. Product Life Cycle Theory

Vernon (1966: 190) developed a strategic perspective called Product Life Cycle. The purpose of the model is stressing the important role of innovation, scale economies, and uncertainty on the overseas operations of firms. According to this model, a firm's aim of making foreign investments is to protect the market where they conducted their export activities (Doh, 2005: 698). This protection is provided by the unique innovations of the firms in the local market. In the PLC, firms experience five stages;

- **Introduction:** The firm firstly starts to produce in its home market so as to decrease the risk of failure, since the firm is unfamiliar to the markets outside its home market and the perceived risk is high. After it launches its products, it gains market share.
- **Growth:** In this stage, the firm starts to export and achieves economies of scale. There is an increase in the amount of resource committed to overseas markets. In addition, there is an upward trend for the sales.
- **Maturity:** The product becomes standardized. The competitors who are in the markets to which the firm previously exported its products start to imitate and sell the same product to the emerging markets. Therefore, the innovator firm's profitability is in decrease.
- **Saturation:** As the market becomes saturated, the firm needs to undertake new product innovations so as not to lose its market position. In this stage, there is still a decrease in sales and by the same token, the firm's profitability is declining.

- Decline: In this stage, the demand for the product is over. The demand for the product is completely saturated and there is a demand a new product.

The model is based upon the incremental internationalization of both a product and also an innovative company. As the product reaches to markets outside the home market and also produced by other firms, it becomes internationalized as well (Melin, 1992: 114). The PLC focuses on how an industry develops through the innovations of the firms when they are internationalizing their products.

1.2.2.2. Monopolistic Advantage Theory

According to Monopolistic Advantage Theory (Hymer, 1976), international firms exist due to the superiority of their resources that make them have an edge over their competitors and those advantages can only be acquired and owned by one multinational enterprise. The theory suggests that firms internationalize so as to optimize their costs and increase revenues across international borders.

Each market has its own advantages such as low labor costs, cheap raw materials or well-educated but cheaper workforce, when firms combine all those advantages they achieve superior performance compared to their competitors. Firms can achieve cost efficiency through cheap production facilities in countries where they operate. The multinational firms exist due to those opportunities created by market imperfections and through these opportunities firms earn higher returns as they sell goods and services across borders (Buckley and Casson, 1976: 25).

A market imperfection can be the state of a country that lacks some resources, sufficient infrastructures or low trade barriers. Thus, firms will choose locations where they can enjoy low-cost activities with the required but cheaper resources and they will continue internationalization till the point at which the costs outweigh the benefits of internationalization (Buckley, 1988: 182). Those costs emerge as the number of operations increase, since coordination and controlling of scattered operations across markets increase as well.

1.2.2.3. Eclectic Paradigm

The Eclectic Paradigm is considered as the roots of the International Business in the literature (Cantwell et al., 2010: 567). The Eclectic Paradigm (Dunning, 1988: 5) emphasizes the three factors that drive firms to involve in foreign production. Owner-specific advantages, location advantages and internalization advantages are the centre of the theory (Buckley, 1988; Rugman, 1980).

The internalization advantage which is the core element of the Eclectic Paradigm focuses on the existing reasons of the international firms due to the market failure (Johanson and Vahlne, 2013: 190). It states that "firms can control and coordinate the resources that they own but the use of other resources are in control of the market mechanism" (Coase, 1937). Firms can achieve high level of profit through using their competencies and resources in various market operations.

The locational advantage states that firms will establish their production units where they can find advantages such as cheap land, better transportation facilities at lower price and cheap raw materials for production (Johanson and Vahlne, 1990: 12).

The ownership advantage is the intellectual knowledge and know-how of the firm which cannot be imitated by others and firms can use those competencies in markets where the others lack (Dunning and Lundan, 2008: 267). Only through those ownership advantages firms can survive in overseas markets (Johanson and Vahlne, 2013: 191).

The eclectic paradigm emphasizes the transaction and factors costs. Transaction costs represent the procedural costs that firms are exposed to when buying or selling any goods or products such as taxes or high tariffs. The factor costs stand for the production costs of inputs that will be used in production of any goods. Firms seek locations where they can find those costs at the lowest level.

All the theories mentioned above scrutinize the economic aspects of the internationalization. They answer the question of why firms operate outside their home market. They focus on the economical drivers of internationalization. However, the internationalization theory which will be discussed below shed lights on how firms become international players in the global arena and also the changes and commitments they make during this process. Some of those firms are born

international, for the rest it may take a long time to make huge investments in overseas markets.

1.3. INTERNATIONALIZATION MODELS

The theory of internationalization states that internationalization is a slow incremental growth process through which a firm gathers knowledge as it extends its outward operations (Fina and Rugman; 1996: 201). Firms are prone to entering the markets to which they are familiar in terms of culture, language or any business practices, or markets that are geographically close. Entering each new market makes the firm more experienced and knowledgeable, which in turn, affects the firms' next commitments in potential markets. Since each country market has its own features, firms are exposed to adapt themselves by changing their existing way of doing business.

The major internationalization models mentioned in the literature are The Uppsala Model, Network Approach and the Born Global which will be explained in detail.

1.3.1. The Uppsala Internationalization Model

Researchers from the Scandinavian Uppsala School developed "Uppsala Model" which is based on a sequential evolutionary process of a firm, wherein each step a firm builds more commitment through the knowledge gained from its own operations in foreign markets (Johanson and Vahlne, 1990: 12; Eriksson et al., 1997: 342). Johanson and Wiedersheim-Paul (1975) developed the model based on the process four Swedish multinational firms experienced. The focal point in this empirical model is the effect of market knowledge on the resource commitment during the internationalization process of the firm. Firms start to enter the markets which are close in distance or perception so as to decrease the risk and the uncertainty. Through this process, the firm gains knowledge and use that knowledge in determining the level of commitment in the operations for the future foreign markets targeted. Knowledge and commitment are stated as two main factors

affecting firm's internationalization decisions (Johanson and Wiedersheim-Paul, 1975: 306). Johanson and Vahlne (1977: 34) assert that as learning from the knowledge acquired in each step increases, the level of commitment increases as well, since the experiential knowledge reduces the market uncertainty and perceived risk, which affects the market choice of firms provided as they do not lack of knowledge and the firm perceives the risk lower than the highest tolerable risk; it steps into a new market. The knowledge and experience gained in each market decreases the level of unfamiliarity of the firms to the markets they previously perceived risky. The more knowledge they have about the market, the lower the uncertainty and risk is perceived, thus the higher levels of commitment are made. If the firm perceives that the risk of failure is low, they become willing to make huge investments.

According to Johanson and Vahlne (1990: 24) "firms enter new markets with greater level of psychic distance", which is defined as the factors hampering the flow of information from market to the firm, affects the firms' overseas operation decisions. Those factors are related to the differences between countries in terms of culture, geography, industry, politics, business practices, and language (Johanson and Vahlne, 1977: 24). Thus firms are prone to starting with culturally and geographically close countries or usually neighboring countries that are similar in terms of business practice so as to minimize uncertainty. Learning from the experiential knowledge enables firms to overcome the psychic distance (Melin, 1992: 114).

Entering the markets which are psychically distant, increases the firms uncertainty perception (Evans and Mavondo, 2002). If the firm has enough knowledge about the market, it decreases the level of uncertainty on the prediction of what kind of challenges the firm may encounter (Yamin and Sinkovics, 2006: 340). If the firm lacks of knowledge, this situation will increase the perceived risk of failure as the firm does not know the challenges they face and how to overcome those challenges through new strategic adoptions. Firms go under a number of innovation strategies to overcome their perceived risk and take advantage of the opportunities in those markets distant in perception (Azar and Drogendijk, 2014: 584).

In summary, there are 4 main stages in the internationalization process that firms experience. However, some firms can reap some stages due to their intellectual and financial resources (Beamish and Calof, 1995: 117). All stages differ in terms of knowledge, commitment and the level of risk they harbor in itself. As can be understood, the learning process shows an increasing pattern of knowledge and commitment. In each step the firm gets more experienced and knowledgeable about the markets that results in high levels of commitment. These 4 main stages are;

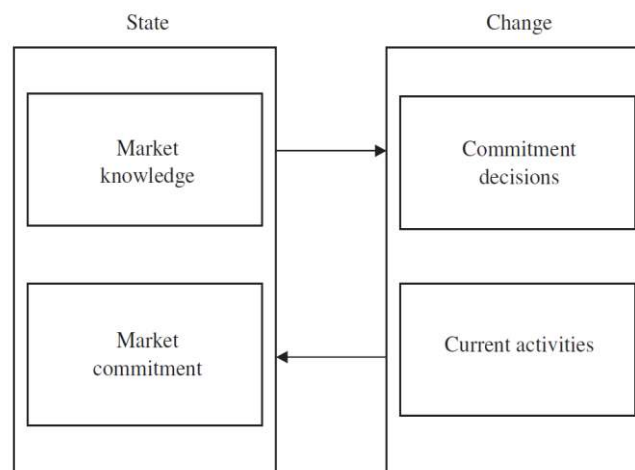
1. Lack of regular export activities: At the first step, the firm is unwilling to take any risk since it has no market channel to get information. Therefore, the level of commitment is zero with the high level of psychic distance and it operates in the domestic market. As it learns from its operations, the firm will start to invest in overseas markets.
2. Exporting through independent representatives: Having the market channels through independent agencies enables the firm to acquire information about the market and firm has an export department responsible for the agencies.
3. Sales Subsidiaries: After experiencing the second stage, the firm has the ability to control the information about the market and as a result the establishments of sales subsidiaries take place. Those sales subsidiaries provide an accurate and reliable flow of information for the firm.
4. Production/Manufacturing Units: At the last stage, the firm engages in the highest level of resource commitment compared to the previous stages due to the experiential market knowledge gained, which enables the company to overcome the psychic distance and as a result, the firm has its own production units in different countries. The firm becomes able to control and coordinate its operations through the experiential knowledge which was gained in its operations, this situation constitutes an intellectual asset for the firm.

This evolutionary sequential process is called "the established chain" (Whitelock, 2002: 342). Each stage involves an increasing commitment to international activities, commitment increases as the firm learns more about the market, which in turn, decreases the uncertainty about the foreign markets (Bilkey

and Tesar, 1977: 93; Johanson and Vahlne, 1977: 27). During this chain, there are also different factors affecting firm's international operations in different stages like market opportunities, the size of the market, the level of competitiveness in that market (Johanson and Wiedersheim-Paul, 1975: 308). If the firm has enough resources, it may prefer to enter into large markets rather than small ones. In the case of Swedish firms, it is observed that some companies did not experience the whole process and they skipped some of the steps according to Johanson and Wiedersheim (1975: 321), which can be due to the market conditions or the firm's foreign market experiences.

The model was further developed by Johanson and Vahlne (1977: 26) which is based on four main factors including "market commitment, market knowledge, commitment decisions and current activities". Those are the factors of two aspects so-called stage and change (shown in Figure 1). The stage aspect comprises of market commitment and market knowledge whereas the change aspect consists of commitment decisions and current activities. The stage aspect directly affects the change aspect (Johanson and Vahlne, 1990: 11).

Figure 1: Basic Mechanism of Internationalization: State and Change Aspect



Source: Johanson and Vahlne, 1977: 26

Experience is stated as the major source of the knowledge which affects the decisions about the change aspect. There are two kinds of knowledge according to

Penrose's (1959) standpoint that are "objective knowledge" which can be taught and "experiential knowledge" which can only be gained through personal experience and cannot be transmitted as having a tacit knowledge character. The individuals in the firm are the only holders of the experiential knowledge. Experiential knowledge is a crucial factor since it decreases the uncertainty related to the market commitment and in addition, it provides the firm to perceive more opportunities in the market (Buckley and Ghauri, 1994: 12). Therefore, it is the driver of the firm in the internationalization process.

Market commitment has two dimensions, the first one is the amount of commitment reflecting the total amount of investment in the market. The second one is the degree of commitment that shows the degree of the specialized resources committed to a specific market. In other words; the higher specialized the resources are, the higher the degree of involvement is. Commitment decisions are about the resources to commit in a market, which are made upon the risks and opportunities perceived in the targeted market. Decisions on the commitment are made upon the knowledge the firm has about the market.

For some researchers, this model has some short comings which are accepted by Vahlne and Johanson (1990: 27). The most criticized point is the deterministic nature of the model (Melin, 1992: 115; Beamish and Calof, 1995: 117). Some researchers claim that firms can internationalize in a different manner (Newbold et al., 1978; Turnbull and Valla, 1987; Millington and Bayliss, 1990: 159). Beamish and Calof (1995: 117) state that firms can skip certain stages provided as they have enough resources and larger firms can skip easier than small ones.

Millington and Bayliss (1990: 159) found the sequential internationalization as an exceptional situation. In a research based on the internationalization of Swedish technical consultants, it is found that the firms did not follow a sequential process which means the internationalization process model is not accurate in the service industry (Johanson and Sharma, 1997). Moreover, Johanson and Vahlne (2006) admitted that they did not emphasize the importance of opportunity aspect of internationalization. They overlooked the opportunities that the internationalization offers for the firms such as the economies of scale and scope. Also firms can enjoy the cheap resources through which they can achieve cost efficiency.

In the case of Uppsala, the main factor affecting the involvement is the market knowledge but several studies found the level of involvement is also affected by the perceptions of managers about the opportunities, risks, and size of the targeted market (Bilkey and Tesar, 1977: 94). The effect of managers on this process is asserted by Reuber and Fischer (1997: 808). Through the skills and international experience of the managers firms can skip some stages. The success in the international markets is not only based on the strategy followed and the product launched to the market but also the management attitudes must be appropriate (Beamish and Calof, 1994: 105).

In some studies; it is stated that firms can gather knowledge through their relationships with other firms (Eriksson et al., 1997: 338; Hansen, 1999; Kraatz, 1998; Lane and Lubotkin, 1998; Levitt and March, 1988). Forsgren (2002: 260) pointed that firms can learn by imitating others, incorporating with other people, network partners and other firms or search for the information they need. However, in the Uppsala Model learning is merely linked to the experiences gained in specific markets. By doing so, they will stick to specific markets and gain knowledge about them rather than entering into new markets. When a firm from the domestic market and another international firm cooperate with each other, they learn from each other and have an opportunity to engage in new business activities, which means, a long knowledge bridge that creates more opportunities. However, being a member of a relationship has its own costs (Eriksson et al., 1997: 339). The partners can abuse the mutual trust or one partner can become opportunistic, if the other partner is highly dependent.

Another shortcoming is that "due to the homogenous world the psychic distance level has decreased" but in the Uppsala model the level of psychic distance differs slightly between the stages (Melin, 1992: 100).

1.3.2. Network Approach to Internationalization

As internationalization increases, the opportunities in the world market increase as well but at the same time the level of performance standards in terms of quality and cost increase (Hitt et al., 1999). This situation drives firms to cooperate

with each other as they lack the important resources to be successful in the competitive market place (Kotler, 1977).

Johanson and Matsson (1988) state that firms operating in a market are interconnected and interdependent with one another and this interconnectedness takes place through the networks. Firms have to build relations with the actors in the market to access to the external resources controlled by other firms and those players in the market can be customers, distributors, suppliers and sometimes competitors. Through the network, firms can generate opportunities, learn from experiences, take advantage of the important resources, acquire international knowledge (Chetty and Blankenburg Holm, 2000: 77).

In addition, resource based theory suggests that network relationships provide firms an opportunity to access the resources they lack (Hessels and Parker, 2013: 138). Through those resources, they gain competitive advantages over the others out of the network. The actors in a network transfer their resources and act as a complementary partner. In short, firms do not have to own all the resources they need. The external relationships help them to overcome their both financial and human resource constraints. Firms can also learn from their network partners when adapting to each other, they become more flexible when they cooperate with different firms (Welch and Welch, 1996: 12). Firms can gain a great deal of knowledge from the actors in their networks. Those partners can sometimes imitate others, especially; if they are going through a risky process (Bonaccorsi, 1992). Especially small firms are the ones that rely on those networks due to their limited resources. A highly internationalized network can offer great opportunities for small firms in terms of knowledge and resources (Hadley and Wilson, 2003: 704).

Another advantage of the network relationships is that it allows the firm to externalize its operations with full control of its assets, which gives them the chance to specialize on what they do best instead of vertical integration. Researchers contend that an internationalized firm positioned in a foreign network has foreign parties to operate. Developing relationships with those actors will provide the firm to see the roles, the strengths and weaknesses of those actors and the opportunities for itself and the positions in a foreign network will lead linkages to other parties and new markets (Blankenburg Holm, 1996; Axellson and Johanson, 1992).

The effects of networks can be in various types on the firm level. They can affect the entry mode of a firm or market selection. Firms can enter the markets in which they have strong network partners. A study by Loane and Bell (2006: 479) showed that firms use networks as a means of knowledge source in order to increase their degree of internationalization.

The networks in internationalization is of importance in the literature (Sharma and Bloomstermo, 2003: 739; Chetty and Wilson; 2003: 62). The network model focuses on the influence of the external players or organizations on the internationalization of the firm (Hadley and Wilson, 2003: 697). From the network perspective, the internationalization of the firm means the establishment and development positions in foreign networks (Johanson and Matsson, 1988). The model developed by Johanson and Matsson (1988) shows the influence of each party's internationalization on the other parties internationalization process. Firms build and develop relationships with the parties in a network so as to extend, penetrate and integrate. The firm's degree of internationalization shows to what extent the firm is integrated, and the level of strength of its positions in various countries.

According to Johanson and Matsson (1988) the internationalization of the firm can be in three ways as described below;

1. International Extension: By establishing relationships with counterparts in different countries.
2. Penetration: By developing the positions through increasing commitment in the foreign countries they have already established.
3. International Integration: By developing coordination between positions in various countries.

Johanson and Mattson (1988) conceptualize the firms according to their the degree of internationalization in four categories.

1. The Early Starter: It is the firm engaging in weak international relationships with low level of foreign market knowledge. Through the agents it enters foreign markets and can use the knowledge of parties in the network (Axelsson and Johanson, 1992; Chetty and Blankenburg Holm, 2000: 84).

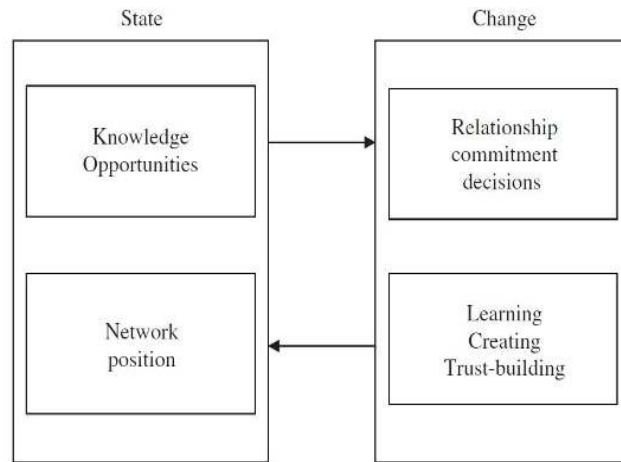
2. **The Late Starter:** It represents a firm operating in a highly internationalized market with few international relationships. As in the Early Starter, the level of commitment is low due to the low level of knowledge and few international networks. The firm can gain knowledge from the other parties in the network (Chetty and Eriksson, 1998). Moreover, the firm's decisions on commitment can be influenced by those actors in the network (McKiernan, 1992). Despite weak relationships, the firm can increase its awareness of the market in which it is operating (Hadley and Wilson, 2003: 703).
3. **The Lonely International:** It refers to a firm with a high level of experience, knowledge, and resources in an inexperienced network. The firm has an advantage over its domestic competitors as since it has already positioned in the network before them (Chetty and Blankenburg Holm, 2000: 80). The firm can blend its knowledge with the new experiences through direct and indirect relationships, which in turn, increases the level of foreign market knowledge.
4. **The International Among Others:** As can be understood from the name; it represents a firm with a high level of internationalization in a highly experienced network. It has a highly internationalized macro position providing the firm with great levels of experience through coordination and integration. During the process, firms' internationalization driven by the networks are influenced by the parties in their network, which is the focus point of the model. Hadley and Wilson (2003: 697) claimed that the level knowledge of the firm differ in each stage. In each further stage, firms are meant to adopt new strategies according to the environment or the market. Those strategies also allow the firm to gain experience and knowledge about the market.

The model has been supported by a number of studies (Johanson and Vahlne, 1992; Chetty and Blankenburg Holm, 2000; Jones and Tagg, 2001). However, some shortcomings of the model have been criticized by some researchers. Chetty and Blankenburg Holm (2000: 79) criticized the model as it does not stress the importance of the decision maker and firm characteristics. In addition to this, the

model does not discuss how to overcome the problems that may arise in network relationships.

Johanson and Vahlne (2009: 1412) developed their Uppsala Model by adding network approach. The new model is shown in Figure 2. They describe the business networks as "the webs of connected relationships" and state that firms need to well establish in those networks to be successful by building trust, commitment and learning. The model makes a combination of experiential learning and commitment as the driver, by focusing on the network relationships and consists of the interaction between state and change variables where learning and commitment influence the knowledge and network position of the firm, which in turn, affects learning and commitment back (shown in Figure 2). According to Johanson and Vahlne (2013: 195), a network is the business environment in which the firm has dyadic relationships with other parties, who are embedded in other such dyadic relationships. Those parties' aims are not only to exchange products but also to exchange knowledge. Firms gain knowledge gradually, as they build trust and strengthen the relationship. The only way of learning is to interact with the parties in the network. Hence, the knowledge developed and potential opportunities in the network are only available for insiders but not for the outsiders (Johanson and Vahlne, 2013: 196). As the firm interacts with the parties, it will explore the opportunities in other markets which will drive the firm to enter new markets.

Figure 2: Business Network Internationalization Process 2009 Version



Source: Johanson and Vahlne, 2009: 1424

As firms learn more about the other parties in the network, they also learn how to coordinate with them and their special skills so as to increase their joint productivity and develop new relationships. Learning and commitment do not only provide the firm with efficiency improvement and growth but also it helps the firm manage the uncertainty. According to Johanson and Vahlne (2009: 1415), relationships are social constructs which are hard and need long time to build. As the firm engages in relationships it builds trust, commitment and acquire knowledge. Relationship development requires reciprocal commitment between two parties and they will make commitment as they learn interactively (Eriksson and Johanson, 1999). The inter-organizational relationships in the network can affect the internationalization patterns of the parties (Coviello and Munro, 1995; Martin et al., 1998). Take for instance, a firm can follow its partner; if the partner has a strong position in the network or the focal firm sees potential opportunities. Another case can rise as the partner wants the focal firm to follow him, any decision made by the focal firm will show the level of commitment to its partner (Johanson and Vahlne, 2009: 1425).

Despite the advantages of being an insider, it has some drawbacks. Developing a relationship is risky, all investments made by a firm can be all in vain (Johanson and Vahlne, 2013: 195). Through the network, firms may lose their market control which may result in weakness in the network position (Coviello and Munro,

1995: 58). If the dependency between the firms engaging a relationship is not in balance, problems are likely to arise.

In the two network approaches, the common issue is the role of knowledge in the evolution process of firms in overseas markets (Hadley and Wilson, 2003: 698). The experience gained from operations are used to decide the strategies to adapt in each new market and also help the firm to overcome the challenges they face in new markets. In the approach by Johanson and Mattson (1988) not only the firm level internationalization but also the internationalization degree of markets are taken into account. Firms' markets are seen as the source of knowledge. In contrast, Johanson and Vahlne (1977) focus on the role of experiential knowledge role on the internationalization of the firm. The point only taken into account is the internationalization degree of the firm.

1.3.3. Born Global

The study conducted by McKinsey (1993) focusing on manufacturing exporters in Australia gave rise to the term Born Global to be coined, which is named as "international new ventures" (McDougall et al., 1994), "born globals" (Knight and Cavusgil, 1996), instant internationals (Preese et al., 1999), and global start-ups (McDougall and Oviatt, 1994). The term Born Global represents a commercial enterprise (McKinsey, 1993; Knight and Cavusgil, 1996), which is defined as "a business organization that, from inception, seek to derive significant competitive advantage from the use of resources and the sale of outputs in multiple countries" (McDougall and Oviatt, 1994). Those enterprises begin to conduct international operations right after or after a short while of their establishment (Madsen and Servais, 1997: 561). They start to compete in international business markets right after from their establishment by raising capital, manufacturing and selling products especially in advanced industries across borders (Oviatt and McDougall, 2005).

Through the facilities provided by the cutting edge technology; low-cost communication, transportation of goods and services, efficiency in production, in short, the reduction in transaction costs, firms are getting more able to see and take advantage of the opportunities in markets. Moreover; under these conditions, a firm

with limited resources can survive in international markets and all these conditions facilitate the emergence of international new ventures (Knight and Cavusgil, 2005: 16). In other words, the cost barriers hampering the firms to operate abroad are no longer the case through the technological developments.

Another upshot of those developments in the markets is the easily mobilizing of human capital which makes numbers of entrepreneurs undergo international business (Johston, 1991; Reich, 1991). The factors triggering the emergence of Born Globals summarized by some researchers are the developments in market conditions, increasing technological developments, increasing numbers of global networks and more elaborate capabilities of people (Rialp et al., 2005: 154). Under those conditions, the markets become borderless and the hierarchies of large enterprises do not have the competitive advantage.

The main feature that distinguishes those firms from the traditional multinational firms is their international origins and orientations as they make commitments of specific resources when they start to operate (McDougall and Oviatt, 2000; Cavusgil and Knight, 2004). Born Globals are usually small sized, technology-based companies, which can pursue the growth opportunities aggressively in international markets due to the their entrepreneurs who have international competences and aware of the growth opportunities in the world market (Knight and Cavusgil, 1996). The role of entrepreneurs in the emergence of the Born Global is of importance. According to some researchers, those entrepreneurs having previous international experience are aware of the opportunities in international arena and through their competences, they are on the alert for any possibilities of the combination of resources from various markets (McDougall et al., 1994: 470). Some of those competences are knowledge and network relationships gained in previous activities. An entrepreneur without those competencies can hardly achieve the combination of those resources crucial for the company's survival. The uncertainty perception of the founder of the born global is low in accordance with his previous international experience which is a necessity for the firm for further international expansion.

Some researches tried to explain the internationalization process of Born Globals and the reasons driving them to internationalize, as these firms "challenge to

the traditional internationalization theories" (Knight and Cavusgil, 1996). Some of them try to apply the Uppsala model while others ignore. Some of them tried to explain the phenomenon through strategic orientation, entrepreneurship, organizational learning and the role of knowledge. McDougall and Oviatt (2005: 538) try to conceptualize internationalization by explaining the effect of market and entrepreneur orientation on the internationalization of Born Global. In some studies, it is suggested that the international entrepreneurial orientation of the founder is the determinant of the speed of the internationalization (Knight and Cavusgil, 1996). In many studies exporting is viewed as an entrepreneurial act (Ibeh and Young, 2001). In the study of McDougall and Oviatt (1994), it is found that none of the firms follow a process mentioned in the Uppsala Model which means the model is not adequate to explain the reasons driving the firms to internationalize which is confirmed by other researchers (Bell, 1995; Knight and Cavusgil, 1996).

As aforementioned, the start-ups differ from the established firms in terms of the amount of resources. The Born Globals have an international vision of the sales of innovative products or services that are marketed via strong networks in international business environment (Ganitsky, 1989; Jolly et al., 1992). They prefer to take advantage of the hybrid structures in order to control their sales and operations, and those firms have a propensity to internationalize their resources crucial for their survival due to their poverty of resources (McDougall et al., 1994: 470; Oviatt and McDougall, 2005: 35). They rely on business and personal networks despite the risk of the loss of proprietary knowledge but those networks can be their competitive advantage as well (McDougall et al., 1994). Partners can assist the company in identifying the opportunities and carrying out negotiations. They can guide them in many ways and help the company to gain a worldwide presence. Some firms internationalize so as to access those kinds of superior network relationships for funding their operations. One of the drawbacks of those hybrid structures is that the partners in the network can abuse the relationship by being opportunistic, which can cause the firms to fail (Larson, 1992). However, the opportunistic behavior can be avoided by developing trust through experiencing more interaction between partners (Aldrich and Zimmer, 1986).

Born Globals compete in international markets through value creation based upon their innovative technology and product design (Rennie, 1993) and they usually produce and sell their advanced technological products in leading markets. They cannot pursue a multidomestic approach like the large firms as they lack of the sufficient scale.

Those models of internationalization points out the evolution process of firms during their expansion in overseas markets. It shows how this process starts at the firm level, the adaptations experienced in terms of organizational, marketing and all business practices. Strategy making is defined by Mintzberg (1987) as taking new positions with new perspectives and internationalization is an continual developing strategic process whereby a firm changes its organization structure and scope of business operations (Melin, 1992: 101).

1.4. THE ASSOCIATION BETWEEN ENTREPRENEURIAL ORIENTATION AND INTERNATIONALIZATION

Entrepreneurship is the process which a firm engages in creating value through the resources so as to take advantages of the opportunities (Ripsas, 1998: 104). It is comprised of the behaviors which are 'risk taking propensity, proactive attitudes and innovativeness' (Covin and Slevin, 1990). However, Lumpkin and Dess (1996: 142) claim that proactiveness differ from aggressiveness, and they take aggressiveness into account as another dimension of entrepreneurship. Innovativeness is "the attitudes and actions taken to create and introduce new products, services, and develop new processes" whereas proactiveness reflects "the exploration and exploitation opportunities such as production of a new product before the competitors in the market" and risk taking is "the propensity to compete aggressively with bold actions" (Lumpkin and Dess, 1996: 138; Wang, 2008: 637). Aggressiveness indicates "the competitive posture of the company towards its competitors". Risk taking shows to what extent the firm is willing to undertake risky projects. Entrepreneurial orientation reflects to what extent a firm engages in those actions (Miller, 1983: 771).

Schumpeter (1934) claimed that entrepreneurs are the engines of not only of the firm but also the national economy. The influences of entrepreneurial actions on internationalization have been noted by several case studies (Fletcher, 2004; Spence and Crick, 2006; Kuivalainen et al., 2004) and shown in some research implications (Cavusgil and Knight, 2004). McDougall and Oviatt (2005) tried to explain the reasons of the existence of international new ventures through the international entrepreneurship orientation and state that the entrepreneur with international experience enters the markets aggressively through the technological advances and those entrepreneurs form new ventures to internationalize. Miller (2011: 875) claimed that entrepreneurial orientation triggers the firms to make new entries and pursue new opportunities.

The risk taking tendency of the firm shows its willingness to make investments (Lumpkin and Dess, 1996: 138) and entering new markets hence it can be argued that the entrepreneurial culture of the firm can affect the internationalization intent of the firm. Since entrepreneurial culture increases the firm's capabilities and willingness to seek international opportunities, the development of an entrepreneurial orientation can affect the intent of conducting operations abroad (Autio et al., 2000: 910). Through the entrepreneurial orientation firms can enter international markets successfully due to the capabilities it provides (Jones and Coviello, 2005: 285; McDougall and Oviatt, 2000). Those unique capabilities can drive the firm to enter new markets (Autio et al., 2000: 910).

1.5. THE ASSOCIATION BETWEEN ORGANIZATIONAL LEARNING AND INTERNATIONALIZATION

The organizational knowledge has an important role in the internationalization process of firms as firms gain knowledge from foreign experiences, they enter new markets (Johanson and Vahlne, 1977: 26). Organizational learning is defined as "the exploitation of the existing knowledge and exploration of new knowledge about the new markets" (Clercq et al., 2005: 410). Organizational learning efforts are consistent with the activities aiming to explore new knowledge and exploit the existing knowledge (Cohen and Levinthal, 1990).

According to Huber (1991: 90), this process is comprised of the knowledge acquisition, knowledge distribution, interpretation of the knowledge and organizational memory. Knowledge acquisition refers to the process in which the actors in the company gather information and the actors in the organization distribute this information throughout the organization. Through the interpretation of this information, it becomes meaningful knowledge. The last step is to store the obtained knowledge for future use (Jiménez and Sanz-Valle, 2011: 409). Organizational learning is one of the competitive advantage sources of the firms. The ability of acquiring and transforming the information into a meaningful knowledge provides a sustainable position in the market (Damanpour et al., 2009: 432).

Clercq et al. (2005: 410) made a categorization between learning efforts, which are domestic and international learning efforts and argue that international learning has a positive effect on the internationalization intent of the firm as the more knowledge firm gains through learning efforts, the more willing it will be to use and exploit this knowledge through international activities.

According to Johanson and Vahlne (1977: 26), as firms gain knowledge, they enter new international markets since the knowledge reduces the uncertainty and makes the firms recognize the opportunities in the markets. Eriksson et al. (1997) state that knowledge about the foreign market will reduce the uncertainty about the cost of further international activities, which can lead to more commitment to markets. Ogbuehi and Longfellow (1994) assert that as the firm gains knowledge from its experiences, it will engage in further export operations and want to facilitate its growth. The role of organizational learning on the internationalization is considered to be crucial since the knowledge is the one of the first determinants of a firm's resource commitment in new markets (Hsu and Pereira, 2008: 190).

Organizational learning is considered to affect entrepreneurial orientation and also entrepreneurial orientation may affect organizational learning as well. As firms learn about the markets they will be able to recognize the opportunities before their rivals then this makes the firm to enter the markets before their rivals. Organizational learning is considered to boost the entrepreneurial flair of the firm due to knowledge acquisition and utilization (Hitt et al., 2003). As knowledge affect the firms innovativeness which is one of the dimension of entrepreneurial

orientation. From another aspect, entrepreneurial orientation affects the culture of the firm which supports learning, sharing and exploiting of knowledge (Covin and Miles, 1999) and it creates an internal environment which open to learn. Wang (2008: 650) found a strong correlation between organizational learning and entrepreneurial orientation.

1.6. CONSEQUENCES OF INTERNATIONALIZATION

A firm's competitive advantage is comprised of its core resources and organizational capabilities (Grant, 1991: 115). A differentiated resource or capability is considered as the primary driver of the success in the international arena. International expansion of firms provide them to acquire valuable knowledge in terms of market and technology through their experiences, which in turn, creates a worldwide known brand name, inimitable intangible resources, know-how, technological capabilities and so on (Hsu and Periera, 2008: 191). International firms are subject to maintain those valuable assets to keep pace with their rivals and achieve targeted performance. Internationally diversified firms have the access to Research and Development (R&D) resources available in overseas markets, that increases their capacity to innovate (Kafouros et al., 2008: 65). In each different market, firms are exposed to different customers and also different competitors, for each market; they have to launch differentiated unique products and services. Through unique products, international firms can increase their profitability.

In addition, internationalized firms can achieve high level of performance through their process innovations (Kotabe et al., 2002). Operating in highly competitive markets pushes firms to undertake innovation activities to increase their flexibility to respond quickly and achieve organizational performance (Silva et al., 2010). Briefly, internationalization can lead greater levels of innovation and firm performance (Azar and Drogendijk, 2014: 582).

In the following chapter, the innovation concept is discussed in detail.

CHAPTER TWO

INNOVATION

2.1. DEFINITION OF INNOVATION

In today's business environment, the current competitive challenges affect the way firms conduct their activities. The flow of technology and knowledge across borders causes rapid changes in markets, which drives firms to introduce higher quality products with the lowest cost in a limited time period (Nieto and Santamaria, 2007: 367). In order to overcome those challenges, firms undergo various innovation processes by transforming the useful knowledge into valuable outputs. The ability to keep pace with the advanced technologies is seen as the key means of competitive advantage and survival of firms (Demirel and Mazzucato, 2012: 45).

In the global arena where giants compete with their unique competencies, firms need to be able to develop new technologies in order to be successful (Guan and Ma, 2003: 738). In recent years, the importance of innovation has been the focus of researchers and firms, as it has been the main driver of the competitive advantage, productivity and economic growth of nations and firms. Especially in dynamic markets, innovation is considered as a crucial means required for firms' long term success (Van De Ven and Rogers, 1988).

As a complex phenomenon, the term innovation has been defined in various ways in the literature (Stoneman, 1995). However, it generally means something new (OECD, 1997: 21). All definitions in the literature encompass developing new products and processes, making changes in organizations and marketing methods, and social system (Stoneman, 1983; Brockhoff 1998). Schumpeter (1934: 65) who is seen as the father of innovation defines innovation as “simply doing new things or doing of things that are already being done in a new way”. He identifies innovation activities in five different ways and claims that a firm can engage in innovation activities through product innovations by launching new products or making changes in an existing product, process innovations by making changes in the methods of production, opening a new market, improving new sources for inputs such as raw materials, and organizational changes. Further; he argues that those breakthrough

innovations will change the whole world market structure, which is called “destructive creation”. Every new innovation will destroy the existing products, systems or structures by creating new ones.

Barnett (1953) claims that innovation is the invention of something new whereas Knight (1967: 478) suggests that any change that is new to an organization can be an innovation. Those changes can be in terms of product, process, and improvements in inputs, organizational structure or marketing methods (Stoneman, 1983; Brockhoff, 1998). As can be understood, there are various definitions of innovation in the literature. Some researchers define innovation as an output whereas it can be defined as a process for some others (Love et al., 1996: 738). In the literature, a definition that encompasses a wide explanation of innovation is made by Vakola and Rezgui (2000: 176), they define innovation as “an idea, product, process, system, or device that is perceived to be new to an individual, a group of people, firms, an industrial sector, a society or to the whole world”. To their view, anything that is new to any person can be considered an innovation as well.

OECD (1997:23) defines innovation in a more technological aspect which is “a new product introduced to a market or a new process improved in an enterprise”. However, the imitation of products or processes introduced previously by other firms can be seen an innovation as well. The developer of the innovation is not of importance which means an innovation can be acquired from other firms or institutions (OECD, 2005: 16). Thus imitation is seen as an innovation as well. Thompson (1965: 4) defines innovation as “a process in which a firm generates and implements new processes, new products or services for the first time within an organization”. Therefore, an innovation has to be new to a firm rather than new to the market or the industry. According to Schumpeterian Trilogy, a technological change occurs in three different stages including invention, innovation and diffusion (Stoneman, 1995). Invention is the generating of new ideas which are transformed into marketable products and processes in the innovation stage (Freeman, 1982:7). Through the social system, these new technologies spread throughout the markets in the world, which is called diffusion. Through diffusion of knowledge and technologies, other firms in the market start to adopt those changes.

2.2. DRIVERS OF INNOVATION

There are a number of reasons why firms undergo innovation activities mentioned in the literature. As environmental volatility caused by globalization increases the challenges, firms seek means to achieve target performance and under those conditions, innovation is considered one of the competencies needed for superior performance (Han et al., 1998). Innovation is seen as a reaction to the volatile external environment of the firms, as they cannot control it but they have to adapt to it (Subramanian and Nilakanta, 1996: 23). Firms use innovation as a key means of long term success in competitive markets (Van De Ven and Rogers, 1988).

The ultimate reason for firms to innovate is to enhance the performance, which can be achieved through cost reduction in production processes or increasing demand for any products (Porter, 1990). Firms can gain a cost advantage by reducing the production costs, through the process innovations they carry out. Any new products or services launched to a market give the chance to be a market leader, to have a competitive advantage and increase market share (OECD, 2005: 29). Through product differentiations, firms can increase the demand for any existing product in the market. In addition, firms innovate so as not to lose their already existing competitive position in the market (Neely et al., 2001: 116). Briefly, in highly intensive globalized markets, price is not the only issue for firms to take into account, they also engage in innovation activities so as to maintain their competitive advantage (Porter, 1990).

All in all, firms must be able to compete with powerful rivals through its intangible assets in dynamic markets where the rules of the game are rapidly changing (Brown and Heisenhard, 1995). Innovative firms are the ones who are capable of reacting to those changes in time with their unique and inimitable assets and also they are the ones who often rewrite the rules of the game (Miles et al., 1978). Firms also can use innovations as the means of creating entry barriers to potential rivals, as in highly innovation intensive markets it is barely possible to capture a market share and position.

2.3. SOURCES OF INNOVATION

Owing to the cutting-edge developments in technology and flow of information, knowledge has become the source of innovation. Innovation is an activity which depends on knowledge more than any economic activity (Audretsch and Feldman, 1996: 634). Firms accelerate the speed of diffusion, application and technological developments due to the fierce competition, which creates a knowledge base competition (Wolff and Pett, 2006). Knowledge is of importance for innovative firms as it distinguishes firms from others in the market. A firm's knowledge asset can boost the firms' creativity and innovativeness (Hage and Aiken, 1970).

There are two alternative ways for firms to access knowledge to innovate. Firms can internally generate the required knowledge or acquire it from external sources. Through engaging Research and Development (R&D) activities, firms can generate the knowledge in their own business. Instead of generating through their resources, firms sometimes would rather buy or exchange technological knowledge such as patented inventions. They can access required tacit knowledge by hiring skilled and experienced workers. Another external source is the network relationships to reach the technological information. Those networks allow firms to access for the sources of information that they cannot generate on their own. Furthermore, through open information sources like exhibitions or fairs, firms can access the knowledge even though it is patented. Firms taking advantage of fairs and exhibitions can increase their innovation success (Falk, 2008: 92). The source of innovation is a crucial issue since it determines the capabilities and skills of the firms necessary for adoption of innovations. For instance, R&D intensive firms should focus on highly skilled and educated workforce while network users need highly innovative partners.

Roper and Love (2001: 650) found that firms can substitute external for internal innovation activities due to skill shortages, financial problems or risks of losing intellectual property rights. This substitution effect may vary by countries. According to their findings, firms in the UK engage in more technological transfers and networking rather than carrying out R&D activities, which is thought to be the result of skill shortages. The sources of information for innovation which are R&D

activities, networks and technology transfers mentioned above will be explained in detail below.

2.3.1. Research and Development

R&D activities are the creative and systematic activities in order to obtain the required knowledge. Those are the research and development activities carried out by an enterprise in the aim of generating the required and valuable knowledge through its own resources in its own house (Roper and Love, 2001: 645). Towards inventions or changes in existing methods, firms can acquire the required specific knowledge by undertaking research activities. They can develop a new product, modify an existing production process and make assessments on to what extent they are feasible (OECD, 2005: 36). Firms undertaking R&D activities are usually large firms due to their sufficient resources required for innovation. In a study, it is found that technological developments are highly human skill based activities, thus, R&D intensive firms employ highly educated and skilled employees (Roper et al., 1996). Radical innovations are usually associated with high R&D expenditures and skilled human capital (Freel, 2003: 766). Since R&D activities are resource-based, firms suffering from financial resources and/or skilled workforce may not be able to engage in those activities on their own, which results in innovation co-operations. Firms also can jointly engage in R&D activities with other organizations. Those partners can be other firms in the supply chain, customers or institutions such as government laboratories.

2.3.2. Networks and Technology Transfers

Innovation can be defined as an evolutionary process which can be affected by institutional, organizational and inter-personal relationships (Grabher and Stark, 1997; Nelson and Winter, 1982). Firms can interact with other firms in order to promote their innovation activities such as cooperation and communication (Arndt and Sternberg, 2000: 467). Through those external linkages, a firm can boost its innovation activities (Freel, 2000).

According to Pyka (2002: 152), it is barely possible for a single firm to keep pace with rapidly changing technologies, which drives firms to exploit external knowledge sources. Firms use networks as a means of coordinating R&D processes through which firms can bring together their new ideas, competencies and technologies to create new technological developments. In brief, they can complete each others' missing parts. Through the diffusion of those competencies, firms become more able to exploit new opportunities in the market, which is not possible to do with their own resources and capabilities.

Networking is a way of accessing knowledge which can be collaborations or sub-contract relationships between firms or enterprises regardless of ownership (Roper et al., 1996). Networks play a crucial role for innovative firms (De Propris, 2002). One of the reasons driving firms to engage in networking activities are the lack of resources and reduction of their transaction costs by sharing resources. Firms lacking of resources can undertake networking as a compensation for their internal resource shortages (Brouwer and Kleinnecht, 1996: 118). Teece (1988) claimed the same standpoint, as weaker innovators may undertake innovation activities through networking so as to minimize the risk of failure. Especially small firms build networks as they suffer from resource constraints, networks are of importance for their survival in the market. Further, large firms are the valuable partners of small firms' networks due to their highly technological and financial wealth.

In addition to resource advantages, firms can benefit from networking in terms of time and risk reduction since any product or process development can be costly and risky that they may not want to undertake alone in a limited time period.

Through networking, they can share cost and risk of innovation activities without time-consuming. Roper et al. (1996) claims that when time is a critical issue, firms prefer networking for a faster development. Hagedoorn and Schankenraad (1990) summarize the drivers of firms to build innovation networks. According to them, firms build networks so as to minimize the cost and risks of R&D, to achieve faster developments to reduce time between discovery of a product or process and launching them to the market, and to be alert to any new technologies and opportunities in the market.

Powell et al. (1996) emphasize that after a firm engages in networking, they will develop themselves, gain experience and build trustworthy relationships through which they can gain reputation. Firms' capabilities to innovate also can energize by those experiences (Nieto and Santamaria, 2007: 368). Several researchers found that the relationships with customers, suppliers, R&D laboratories play a big role for innovative firms (Rothaermel and Deeds, 2006). Especially ties with customers can provide firms with market innovations. Relations with customers and suppliers have a significant effect on firms' innovations. Through interactions with other players such as customers, suppliers or research departments, firms can be alert to any rapid changes in the market (OECD, 2005: 30). By doing so, they can innovate and launch new products or services before their counterparts in the market. Although there are a number of benefits firms can take advantage of; there are some drawbacks of networks firms may experience. Opportunistic behaviors of partners in the network may cause asymmetric information and asset sharing, which generally results in failures (Tripsas et al., 1995).

Technology transfer refers to collaboration between group of companies (Love and Roper, 2001: 645). A business group is different from a traditional company and they have a significant influence on innovation performance of a firm (Chen et al., 2010: 560). A business group is comprised of affiliated firms that act as a network in which exchange of knowledge and resources occurs. Those business groups provide the member companies what they lack for undertaking innovation activities (Khanna and Palepu, 2000a). Affiliated firms have an advantage over the stand-alone firms as group members provide them with know-how, required technologies, information, workforce and financial resources (Mahmood and Mitchell, 2004).

The flow of knowledge in the region has a crucial role in firms' innovation activities as it accelerates learning and innovation as well. The actors in the flow of knowledge in the region are the inter-firm networks and organizations outside from the supply chain. The benefits of technology transfers have been proved in a research covering the firms in the UK and Switzerland, in which independent firms engage in less innovation activities than multi plant corporations (Goddard et al., 1986). This can be explained by the statement made by Thwaites (1978: 446) who emphasizes

the role of parent corporations transferring the economical knowledge to branch plants. Firms in a group of companies can reach R&D facilities or directly innovations developed by other group members.

In a nutshell, there are three means of acquiring the necessary source of knowledge, which are R&D, networking and technological transfer. Firm size, industrial conditions, firms' resource conditions can affect the means chosen to conduct an innovation activity. Firms can undertake R&D activities alone, build networks or collaborate with other firms by exchanging their resources. They can develop new technologies through interactions with others in the market. Those interactions give rise to the diffusion of skills, knowledge, and technologies between firms. Firms learn not only when they develop innovations but also through the interactions they engage. While R&D is of importance in innovative activities, interactions with other firms and research laboratories play a substitutive role to R&D.

2.4. FACTORS AFFECTING INNOVATION

Freel (2003: 752) claims that innovation as a system is exposed to the influences of the social system in which a firm operates, is composed of organizational factors, environmental factors, workforce, policies related to science and technology. In the literature, firms' innovation activities can be affected by a number of factors such as the infrastructure of the environment, the education quality of employees, governmental incentives, policies related to protect intellectual rights and the characteristics of the industry which can be low or high innovation intensive.

As can be understood, innovation is both an external and internal process since it is subject to the effects of the external environment and the effects of the organization itself (Kline and Rosenberg, 1986). Innovative activities depend on skilled workforce, risk taking organizational culture and the environment which supports a firm's entrepreneurial activities in the market. Shortage of qualified workforce, policies related to protecting innovation, risk of failure of a project, expected returns of innovation, financial resource shortages, lack of information

about the markets can hamper the innovative activities of firms (Lim and Shayamala, 2007: 11).

2.4.1. Organizational Factors

In the literature, there is an increasing focus on the skills and characteristics of a firm that influence its innovation activities (Freel, 2005). Organizational characteristics can determine the level of innovation a firm engages. An organization's culture, size, ownership can determine the level of innovation. For instance, organizational flexibility is claimed to affect the innovation activities a firm undertakes, as flexibility provides the firm to adapt to the rapidly changing market conditions or an entrepreneur oriented organization with its flexible structure can decrease the effects of dynamism in the market by quick reactions to the changes (Chow et al., 2004). Furthermore, firm size can determine the level of innovation activities, however, there is still no consensus reached in the literature on whether or not there is a positive or negative association. The same case can be seen in the effect of ownership on innovation in the literature.

2.4.1.1. Firm Size

There are still confrontations on the effect of firm size on innovation in the literature (Mazzucato, 2000: 16). On the one side; firm size is said to affect innovation positively, on the other side of the coin; some researchers claim that there is an inverse association between firm size and innovation.

In a study covering the firms in Germany, Ireland and the UK, it is found that larger firms engage in more innovation activities than small ones in Germany, however, in Ireland an inverse relationship is found. In the UK no clear association is found (Love and Roper, 2001: 650). Rogers (2004: 142) asserts that large firms undertake more innovation activities due to their financial resources to fund sources of innovation by which they can access the valuable knowledge and skilled workforce.

Small firms, as being the resource poor actors in the market, cannot afford to undertake innovation activities as much as the large players. Bajva and Lewis (2003) argue that the reason of why larger firms undertake more innovation is the large number of sales that can cover the innovation costs. Financial resources can provide the large firms to engage in more risky projects (Patel and Pavitt, 1991). Schumpeter (1942) is also one of the authors in favor of the positive relationship between innovation and firm size by arguing that due to required financial and human resources, large firms tend to be more innovative. The resource scarcity of small firms makes them unwilling to undertake innovations, as innovation harbors a high risk of failure which cannot be absorbed by them but can be compensated by large firms through their abundance of resources. As large firms experience more innovation activities, it provides them to develop their organizational capabilities which small firms lack to deal with the uncertainty of innovation (Rosenbusch et al, 2011: 442).

On the contrary, Acs and Audretsch (1988) suggest that small firms tend to engage in more innovation activities since small firms can adapt to the rapid changes in the industry more easily due to their flexible characteristics. In addition, in a study covering firms from the US and the UK, it is found that small firms may have an advantage over their larger competitors, which may be because small firms can be more alert to changes in the market and easily adjust themselves to those changes due to their more flexible management structures (Rogers, 2004: 143).

Although small firms can undertake more innovation activities, Tether (1998) claims that the economic value of innovations implemented by large firms are higher than the ones undertaken by small firms. Hashi and Stojcic (2010: 10) argue that those contradictions on the relationship between size and innovation can be due to the industrial characteristics but not size. Firms' size can also affect the alternative routes firms choose to achieve innovation activities. Large firms may engage in R&D activities more than the small ones due to their adequate financial and human resources needed for innovation engagement, which is not the case for small firms, who make use of external sources. A similar conclusion is reached by Arvanitis and Hollenstein (1996). In their study covering Swiss firms, it is found that small firms tend to make use of external sources, which can be the sign of resource constraints or

risk avoidance attitude of small firms in terms of protection of intellectual rights. Small firms are the players in the market with resource scarcity, which drives them to build networks or collaborate with others in the market, as networks are the means of survival in the market for small firms.

2.4.1.2. Ownership

In the literature, ownership structure is differentiated as external and internal ownership (Bishop and Wiseman, 1999: 443). External ownership is the ownership of a firm from outside of the country where it operates (Love et al., 1996: 740). The exact direction of the relationship between innovation and external ownership is still unclear in the literature. There are some authors in favor of a negative relationship between external control of the firm and innovation; on the other hand, there are some suggestions on a positive relationship (Thwaites, 1978). External or indigenous ownership affects innovation of firms; however, this effect can vary by countries. In a study carried out in Germany, externally owned firms are found to engage in less innovation activities; however, their commercial success of innovations is higher than the local firms. The reason lying on success can be explained by their faster development or highly skilled workforce (Love and Roper, 2001: 656). In contrast, Bishop and Wiseman (1999: 448) found a negative association between external ownership and innovation. This finding is supported by Rogers (2004: 149) who found that foreign firms engage in less innovative activities than local ones. Also, Griffith et al. (2004: 453) found in their study covering the firms in the UK that local firms are more R&D intensive than their foreign owned counterparts.

An explanation of the reasons lying behind the less innovative behaviors of firms is found in a study by Bishop and Wiseman (1999: 444). They suggest that the distance between the head office and branch companies operating across markets can hamper the diffusion of knowledge.

In the literature there are some findings confirming a positive relationship between exogenous ownership and innovation. Sadowski and Sadowski-Rasters (2006: 449) suggest that foreign owned firms are likely to engage in new product and process improvements. This relationship can be an indicator of easily accessible

resources and rapid imitations which make their innovation effort more than local ones. Falk (2008: 89) found that Western European firms are more likely to undertake innovation activities than indigenous firms. Multinational firms especially in business affiliates tend to be large, home to highly skilled workforce can stimulate more innovation activities (Griffith et al., 2004: 451). In a study carried out in Scotland, another confirming result was found. In Scotland, foreign owned firms are more innovation intensive than the local ones (Love et al., 1996: 742). Love et al. (1996: 740) claim that the low innovation intensive characteristics of the local firms may not be about the ownership style, this may be the result of organizational problems for instance managerial constraints.

2.4.1.3. Organizational Culture

Becoming an innovative firm demands not only financial resources and human capital with high level of education but also an organizational culture that promotes innovation and motivated members to undertake innovation successfully (Ahmed, 1998: 31). Organizational culture plays a major role in determination of the level of innovation undertaken in a firm (OECD, 2005: 32). Organizational culture which is “the set of values and norms is the reflection of an organization's internal environment” is asserted as a key to innovation success (Patterson et al., 2005: 380). In a centralized organization, information flow is restricted by the hierarchy between departments which is found as a barrier to organizational creativity and new developments as well. Further, strict rules in the company can hamper implementation of any new developments (Amabile et al., 1996). The attitudes of managers in an innovative organization pursue a developing culture which is home to supportive actions, tolerance and empowerment that trigger the willingness of employees to take responsibility. An organization that pursues a supportive attitude towards its employees can increase the motivation of its employees to generate new ideas necessary for innovation. In flexible organizations, the tolerance for risk taking increases the ability of the firm to overcome uncertainties and shows rapid adaption to the changes in the market.

Creativity is the most important source for innovative organizations. In flexible organizations where rules are reduced, participation is vital, face to face communication takes place, no departmental barriers exist, and the level of creativity is considered in a high level (Ahmed, 1998: 36). In addition, organizational learning plays a vital role for flexible organizations as a way of resource acquisition, since it increases the adaptability of a firm to a changing environment. Organizational flexibility is claimed to increase the ability to innovate (Fairthlough, 1994: 90). Flexibility provides firms with rapid adjustments to changes.

Judge et al. (1997) made a comparison based on the organizational culture and found that centralized companies are less innovative. Although there are a number of authors supporting the positive relationship between organizational flexibility and innovation, there are some others who are not in favor of it. As centralization gives a big authority power to managers, managers can use this power to change, which is good for innovation (Buschungs et al., 2013: 770).

In addition, the manager of the firm should pursue an entrepreneurial attitude to have an innovative edge, which is the source of innovation activities of the firm. Without a spirit of an entrepreneur, firms cannot use their resources wisely through making judgments related to the opportunities in the market (Drucker, 1985). Knight (1921: 268) asserts that risks are the results of rapid changes which cannot be controlled. Entrepreneurs are the risk-bearers who seek opportunities in that uncertain atmosphere and transform those opportunities into valuable outputs. According to Schumpeter (1934) who is an economist, an entrepreneur as an engine of a nation's economy, since they are the ones who seek new ways to use technology or new ideas to make profit, and make great effort to make new ideas become reality (Tidd and Bessant, 2014: 9). Moreover, the intrapreneurs, who are the entrepreneurs inside the company, are the drivers of new ideas, projects with their passionate attitude to change, are the risk-holders in the aim of creating better conditions for the company in the market. Those individuals with an entrepreneur spirit are the leaders of change (Ripras, 1998: 105).

To sum, innovative firms have a posture with their culture supporting change, flexibility and tolerance, well-set purposes and mission, pursuit of continuous improvement and customer satisfaction (Neely et al., 2001: 117).

2.4.2. Industrial Effects

A firm's sector and also region in which it operates can affect its innovation activities. In a study covers 845 Canadian manufacturing firms, R&D intensity is found higher in the firms which operate in industries with high level of R&D intensity (Thornhill, 2006: 687). Furthermore, dynamism in the environment of the industry is one of the determinants of innovation (Miles et al., 2000). In those high-technology industries firms are exposed to rapid changes and high levels of uncertainty, as they need to keep pace with their competitors. Under such conditions, the need of highly skilled workforce is increasing as well. Additionally, firms operating in high-technology sectors such as pharmaceutical sector, innovate more than the ones in low-technology sector such as tobacco, textile or food sectors.

Miller and Friesen (1982) states that entrepreneurial orientation is the key means of overcoming the challenges and maintaining competitive advantage in dynamic industries. In those dynamic industries, firms must be alert to react in any need for innovation otherwise they fail (Yusuf, 2002: 87). Another issue that affects a firm's innovation activities is the technological opportunities in the firm's sectors. Those technological opportunities include R&D intensity, number of firms undertaking innovation activities which the firm can benefit by collaboration or from the flow of technological knowledge.

Further, firms should be able to exploit those opportunities in the industry through their absorptive capacity which means the abilities and skills needed for the evaluation and utilization of knowledge acquired from external environment (Cohen and Levinthal, 1990: 128). Through each innovation undertaken, firms learn more and improve their absorptive capability. The absorptive capability is also of importance in terms of competitive advantage. Technological opportunities are more in a sector where R&D intensity, networking and technology transfers are intensive (Audretsch and Feldman, 1996). Briefly, the intensity of all innovation activities in a sector affects the firm level of innovation intensity. A sector with low level of technological opportunities and small firms can be a home to low level of innovation intensity (Love and Rope, 2001: 657).

2.4.3. Human Capital

In the literature, human capital is claimed to play a crucial role in both national and firm level of innovation. As aforementioned; knowledge as being the main source of innovation, is embodied in people's intelligence and skills, which makes human capital the crucial resource of innovation. Skilled workforce is the means of transmitting the knowledge as they are the source of knowledge spillovers in an industry. The higher the level of skilled workforce in an industry, the more spillovers exists, which in turn, provides another firm to exploit (Audretsch and Feldman, 1996: 634). The education quality of employees and the investments made on human capital such as training positively affects the firm level of innovation (OECD, 2005: 42). Through highly trained or educated workforce, firms can easily develop, adopt and implement a new technology. A highly skilled workforce can increase the level of innovation activities in a firm (Freel, 2005). Highly skilled employees are more adaptive, responsive and proactive, which are the required characteristics to undertake an innovation activity.

The education level of employees in firms is of importance especially in R&D intensive firms. The graduate level of employment in the plant level is found to be important in R&D intensity, however, there is no effect found on networking activities and technological transfer (Love and Roper, 1999: 53). There is an inverse conclusion reached by Rothwell and Beesley (1989) who state that small firms need skilled employees in order to build networks. Firms with a high skill level of employees are better at building social relationships with other actors in the market (Cohen and Levinthal, 1990: 133).

2.4.4. Other Factors

Market share may affect the firm level of innovation. However, there are still some contradictions in the literature (Harris and Moffat, 2011). Blundell et al. (1999) found a positive relationship between market share and the level of innovation of manufacturing plants in the UK. Firms can show persistency in their innovation activities so as not to lose their already existing market shares or to increase their

market shares. Geroski (1990) confirms that firms with high market share are innovation intensive since they are alert to any technological opportunities in the industry. Firms with power in the market may tend to reduce networking activities since they have the required resources to engage in R&D activities, which results in less innovation (Love and Roper, 1999: 31). According to Schumpeter (1942) oligopolistic or monopolistic market structure plays a stimulating role for firm innovation.

Innovation capability of the firm is of importance in terms of innovation activities (Guan and Ma, 2003: 738). Barney (1991) states that the resources and capabilities of a firm is the first source of its competitive advantages. Innovation capability is defined as “the capacity of firm in terms of developing new technologies and utilizing these technologies to satisfy customers with products, processes and services” (Adler and Shenbar, 1990: 35). Innovation capability of a firm determines its innovation success in the market in terms of time and quality since firms have to react to those in markets in the right time with the right products, which is possible only with strong innovation capability (Sen and Egelhoff, 2000: 175).

Firms' investments in innovation activities depend on *the expected returns* (Geroski, 1990: 586). Especially, firms investing in R&D activities take the post-innovation returns into account as those activities are extremely costly (Love and Roper, 2001: 645).

Market demand influences the level of innovation as it has a stimulating effect on innovation (Roper and Love, 1999: 59). Piva and Vivarelli (2007: 692) suggest that sales have a stimulating effect on innovation. As the sales of the company increases, its likelihood to undertake innovation activities increases as well. Moreover, export market demand can affect innovation positively as local market demand does (Roper and Love, 2002: 1100). Piva and Vivarelli (2007: 698) reached a conclusion that sales in export market has a positive effect on innovation since as the international sales increases, the R&D investments of the firms increase as well.

Location of a firm can affect its level of innovation activities (Love and Roper, 2001: 643). Firms can cluster in a specific region where they can exploit knowledge spillovers. Through knowledge spillovers, they can access the new economic knowledge. They may locate close to other companies, laboratories or

universities (Audretsch and Feldman, 1996: 638). *Structural weaknesses* can cause a low value added industry with low productivity firms to innovate due to the lack of enough technological opportunities that can be generated. Those weaknesses limit the innovation activities of firms. Firms operating in structurally strong regions can enjoy the high level of technological opportunities, which in turn, drives them to be more innovation intensive.

Governmental support or incentives can be a motivation for firms to innovate and also *policies to protect intellectual rights* can affect the decisions of a firm to innovate (OECD, 2005: 42). Financial supports and tax reductions provided by the governments increase the likelihood of firms to undertake innovation activities. Firms may find conducting innovation activities risky where is a probability of losing their valuable knowledge or technology, which results in imitation. Appropriability of an environment shows that to what extent firms intellectual rights or innovations are being protected (Malerba and Orsenigo, 1996: 453). In this aspect, governmental policies play a big role in protecting the intellectual property rights. Firms can undertake various ways of protecting their intellectual property such as patents.

As can be understood, there are a range of external and internal actors affecting the innovation activities needed for superior performance in the global arena (Tidd and Bessant, 2014: 71).

2.5. INNOVATION TYPES

Today's global environment harbors a number of changes in terms of markets, business models, products, processes, organizational issues and marketing tools, all of which directly affect the everyday life of human beings. The invention of telephone gave rise to a revolution on the communication and it created a market in which people communicate person-to-person in distance. The introduction of the internet changed the rules of daily life of people as well as the business world such as the online-shopping, online auctions or online-ticket services. Innovation can be creating new markets, producing new products or services to a mature market, serving goods or services to the markets previously undermined (Tidd and Bessant, 2014: 24). For instance, low-cost airline companies changed the rules of the air travel

by serving the vast population who were not targeted previously but are now a big potential for them. Firms start to be alerted by the idea of producing and serving for the people who are at the lowest income level with a population of more than 4 billion that constitutes the bottom of the pyramid as Prahalad and Hart (2002: 9) point out. Firms can change their market segments, product positioning, tools they use in manufacturing and open up new markets, which are some of the innovation activities undertaken.

In the literature, innovations are categorized in various ways (Garcia and Calantone, 2002: 110). However, innovation is mostly considered as product or process innovations (Walker, 2004: 7). There are radical innovations and incremental innovations, which is a novelty based categorization (Schumpeter, 1934). Another novelty categorization show to what extent the innovation is new, which includes firm level, market level and world level innovations. A similar categorization is made by Stoneman (1995), which divides innovation into global and local innovations. OECD (2005: 47) categorizes innovations as product innovations, process innovations, organizational innovations and marketing innovations. In the literature, organizational innovations can be called as managerial or administrative innovations.

2.5.1. Firm - Market - World Level Novelty of Innovations

As aforementioned, innovation can be new to the firm, new to the market or new to the world. An innovative activity should be at least new to the firm to be in an innovation category. The firm level novelty expresses that the firm adopts a new product, process, marketing method or organizational method introduced by other firms previously. A market level novelty indicates the introduction made by a firm for the first time before its competitors in its market. It can also be in a certain region or the markets in which the firms operates (OECD, 2005: 18). When an innovation is introduced to all markets for the first time by an enterprise, it gets into a world novelty degree of innovation.

2.5.2. Radical versus Incremental Innovation

In the literature, innovations are categorized in novelty content. A firm carries out a radical innovation, if it introduces fundamental technological changes. Those innovations make disruptive changes in the markets and bring about other changes (Steele, 1989). Schumpeter (1934) states that radical innovations are the events that affect the existing competition in the market and bring a more intense competitive atmosphere to the market. This change is called as 'creative destruction' since; radical innovations change the frame in which existing firms run their business (Schumpeter, 1934). They are all exposed to adapt to this new competitive arena where rules of the game change rapidly, otherwise they jeopardize their presence in the market. Those innovations are not like daily events; in contrast they occur quite rare (Tidd and Bessant, 2014: 32). Take for instance, the invention and introduction of internet and its diffusion throughout the world has changed how we communicate, the way of doing business and many other things.

An incremental innovation is the introduction of improvements or changes in an existing product or processes. In brief, an incremental innovation is the way of doing something better but a radical innovation refers to do something totally different from what used to exist (Tidd and Bessant, 2014: 71). Incremental innovations are usually continuous events occurred in an industry. The firms that launch radical innovations are seen as the leaders of markets and the ones introduce incremental innovations are seen as the followers. Firms undertaking radical innovations enjoy the high returns of their investments (Mensch, 1975).

2.5.3. Global versus Local Innovations

A categorization made by Stoneman (1995) is based on the first use of a product or a production technology in an industry for the first time. This type of innovation is called 'Global Innovation' which affects the whole world markets. In contrast, 'Local Innovation' is the event that has been introduced previously in other markets or firms, but still new to an enterprise.

2.5.4. Product - Process - Organizational - Marketing Innovation

As mentioned before, Oslo Manual (2005: 47) makes a categorization which includes Product Innovations, Process Innovations, Organizational Innovations and Marketing Innovations. In the literature, innovation is mostly viewed in terms of technological aspects whereas the studies on organizational and marketing innovation are scarce (Birkinshaw et al., 2008). Each type of those innovations has different characteristics with their different area of adoption (Damanpour et al., 2009: 651). A firm can engage in different innovation types due to the environmental factors or the strategy it pursues for growth (Utterback and Abernathy, 1975: 640).

In addition, in the literature, it can be also found that some authors can name the organizational innovations as managerial innovations and name all the innovation types as organizational innovations (Damanpour et al, 2009).

2.5.4.1. Product Innovation

A product innovation is “the application of new technologies to goods and services in the market” (Utterback and Abernathy, 1975: 642). A product innovation can be producing something totally new or making some significant changes in an existing good or service. Those changes can include improvements, upgrades or fundamental changes in goods or services (Li and Atuahene-Gima, 2001: 1124). For instance, the introduction of Windows 8 after Windows 7 can be an incremental product innovation. The first introduction of hybrid car can be an example for radical product innovation.

A product innovation in services is the significant changes or additions to how a service is provided (Baba, 2012: 223). Those changes can be applied to characteristics of services. For instance, Internet Banking is a fundamental change in service sector. The speed and ease of use have been improved. Furthermore, electronic services provided by some firms are also service innovation such as electronic appointment systems of hospitals can be an example for service innovations. Online check-in facility is also a radical service innovation. Product innovations offer a lot of advantages to the firms.

2.5.4.2. Process Innovation

A process innovation refers to “the improvements in the methods of production and delivery” (Bates and Flynn, 1995: 236). A firm can engage in developments in its production system or service operation (Damanpour and Gopalakrishnan, 2001: 48). Those changes can be in terms of techniques, software or equipment applied to the process of production or delivery. An example can be the replacement of human workforce by a computer assisted machinery system in a plant which results in efficiency in time. In terms of delivery, there are some significant improvements such as the use of GPS in logistics or in tourism industry to identify the location of the vehicle. Radio Frequency Identification is a process innovation as it provides easiness for tracking goods. Another example for process innovation can be using Six Sigma or Just in Time in a production process. The use of a 3D design technology in production is another example for process innovation.

Firms engage in process innovations in order to achieve time and cost efficiency, increase service quality and become more flexible (Walker, 2008). Firms can both engage in process and product innovations simultaneously; however, firms engaging in process innovations may not focus on product innovations. Firms engage in product innovations so as to gain market share through the sales but firms pursue process innovations to gain market share through low-cost production (Koellinger, 2008: 1319).

To sum, if the innovation is applied to main characteristics of a product or service, it is a product innovation. If the innovation is applied to the methods of production or manufacturing such as use of new machineries or software system, and skills; it is a process innovation.

2.5.4.3. Marketing Innovation

A marketing innovation refers to “any changes made in marketing methods of the firm to fulfill customer needs and wants” (Levitt, 1960: 2). Those changes can be in product, place, promotion and price strategies, briefly in four P's of marketing. Firms make new combinations of the marketing instruments to create a more

competitive posture with distinguishing capabilities. The major aim is to increase the life quality of customers by meeting their needs and wants in a better way through the innovations in marketing tools, which in turn, increases the sales of the firm (Bennett and Cooper, 1979).

Firms are in need of implementing different marketing innovations so as to take advantage of opportunities in the market and to satisfy the customers, which will result in high number of sales (Porter, 1985). Through marketing innovations, firms can both increase their market shares and acquire unique market positions, and also create new markets. According to OECD (2005: 49), a marketing innovation should be new to the firm and be different from the existing marketing concepts or strategies previously used by the firm. However, those new strategies can be applied to a new or previously existing product. For example, a change in design of an existing product is a marketing innovation. Although a change in the product design is a part of product innovation, if the change is only on the appearance but not fundamental characteristics of the product, this is a marketing innovation. For example a firm can change its packaging methods of its products or it can change its promotion strategies. Online selling is also a marketing innovation in product distribution as a new channel for selling products or services.

The main difference between a product innovation and marketing innovation is that a product innovation is the changes in the functions of a product. A marketing innovation involves changes applied to the appearance or simply the design of the product. However, innovations can be both in marketing and product category.

2.5.4.4. Organizational Innovation

Organizational innovation refers to the changes in business practices of an organization (Birkinshaw et al., 2008: 826). Damanpour and Aravind (2011: 424) named the organizational innovation as managerial innovation. It indicates "the new organizational structures, administrative systems, management practices, processes and techniques". Knight (1967: 482) defined organizational innovation as "the changes in the organizations' authority relations and business practices". Organizational innovations are considered as the reactions of a firm to its external

environment to be able adapt to the rapidly changing environment (Lawrence and Lorsch, 1967). Adopting those innovations enhance organizational performance (Dos Santos and Pfeffers, 1995: 243).

Organizational innovations can be the structure of the organization to facilitate learning and flow of knowledge in the organization, integration of some departments, training programs for employees, strategic orientations or culture it owns (OECD, 2008: 37; Walker, 2008). Firms can undergo changes in terms of their databases for a better knowledge sharing system, they can promote an organizational atmosphere which harbors teamwork, a better coordination and collaboration system and learning orientation (Gunday et al, 2011: 663).

In addition, firms can change their structure such as they can depart from a centralized structure to a flexible organization in which more interactions and encouragements for new ideas take place (Submarinan and Nilakanta, 1996: 634). Another example for organizational innovation can be changes in rewarding systems of employees or changes in external relations for more knowledge exploitation and being alert to the opportunities in the market. It is asserted that mergers, joint ventures or acquisitions are not organizational innovations (OECD, 2005: 52). Total quality management, just in time production, 360 degree feedback are another examples for organizational innovations,

2.6. THE ASSOCIATION BETWEEN INNOVATION AND INTERNATIONALIZATION

There is no consensus reached yet on direction of the relationship between internationalization and innovation. On the one side, some authors claim that innovation is one of the determinants of internationalization (Sigh and Gaur, 2013; Chen and Tan, 2012; Chadha, 2009; Roper and Love, 2002) and on the other side some authors claim vice versa (Bayraktaroglu et al., 2012; Kafouros et al., 2008; Peng, 2001).

There are a number of advantages internationalization offers to firms. Firms operating in global markets have a chance to benefit from market opportunities, market imperfections and building relationships with other firms having different

capabilities or competences. Operating in overseas markets boosts firms' knowledge and learning capacity (Azar and Drogendijk, 2014: 582). According to Johanson and Vahlne (1977: 24) learning is the key element of the firms during their internationalization process in which firms exploit foreign market opportunities and imperfections. They learn from their customers, suppliers, and competitors during their operations.

In each different market, firms gather different perspective of ideas of different cultures with different customer needs and wants and those ideas, in turn, trigger innovation since wants and needs differ in markets and firms need to adopt their marketing and business tools to those differences (Hitt et al., 1994). Hobday (1995) points out that firms operating in overseas markets can exploit the flow of knowledge. As firms enter new markets, they acquire new knowledge and capabilities to develop new products and services (Peng, 2001; Kafouros et al., 2008: 64; Kotabe et al., 2002). International diversification helps firms access the resources required to acquire innovation capabilities (Kotabe, 1990). In addition, internationalization can play a stimulating role in undertaking innovation activities as firms need to capture market shares in new markets (Falk, 2008: 90). Therefore, Kafouros et al. (2008) claim that internationalization results in high levels of innovation activities. Similar to this claim, there are a number of arguments that strongly claim that internationalization is one of the factors leading to innovation (Hitt et al., 1997: 768).

Know-how is an important resource for internationalized firms to engage in product and process improvements (Wolff and Pett, 2006: 273). Those technological competencies gained in international markets allow firms to produce unique products or services by which they gain competitive advantage. As they want to maintain their positions in international markets they will continue engaging in product and process improvement activities since the sustainable competitive advantage relies on the firms' special capabilities and the resources (Fong and Ocampo, 2010: 96). In addition to this, the high returns of innovation activities may stimulate the next investment in new innovation activities (Hitt et al., 1997: 774). In this view, firms aiming to pursue successful operations in international markets need to engage in innovation activities (Alejandro and Osuna, 2014: 74).

Furthermore, firms build network relationships to internationalize and those relationships allow them to access important resources necessary for innovation (Grandstrand, 1998; Cohen and Levinthal, 1990). These information channels are the key means of the cutting-edge technological improvements (OECD, 1997: 22). Firms can hire highly specialized human capital for their production units such as technologists or engineers, which enhance their innovation activities in international markets (Cheng and Bolon, 1993; Kafouros et al., 2008).

In brief, globally engaged firms not only learn from their own activities but also have an opportunity to reach the knowledge for innovation activities, those do not export, lack of ability and capability to reach those knowledge. Exporting provides firms to enhance their innovative capability through the knowledge they gain from the network establishments, which in turn, will increase the product and service quality of the firms (Guan and Ma, 2003: 737). Especially R&D intensive firms can reach or generate the necessary resources through the networks they build during their internationalization process. Additionally, firms operating across markets are exposed to fiercer competitive markets than those operating only in domestic markets. Thus, they need to be able to keep pace with the latest developments in the market to achieve success. Under those conditions they increase the extend of innovation activities. An international firm at least should have the capability to develop product and process innovations so as to gain competitive advantage in global markets (Porter, 1990).

The long-term success of international firms depends on their abilities and capabilities on product and process innovations (Hitt et al., 1997: 770). Innovation is the key component that provides great deal of adaptability of the firm to the environment and as their level of adaptability increases, it will be easier for them to overcome uncertainties they face in each new market (Coronado et al., 2008). Rogers (2004: 150) suggests that internationalized firms are more innovation intensive since they have more powerful competitors. A study conducted in Germany covering 2019 German firms operating in service sector indicates that exporters undertake more innovation activities, which is the evidence of the idea that there is a correlation between internationalization and innovation. An exporter can be a potential product or process innovator. Falk (2008: 92) conducted a study covering 28.000 European

firms and made a conclusion that firms compete in international arena are more innovation intensive than the ones operating in only domestic markets.

To sum up, internationalization is a driving force for innovation as it triggers the innovation abilities of the firms through learning and increases the novelty or number of the innovations they undertake to maintain their competitive advantages in the global arena (Hitt et al., 1997: 775).

As can be understood, internationalization can result in high level of innovations which can have a boosting effect on firm performance. In other words, internationalization directly affects the level of innovation that firms engage, which in turn, reflects to the firm performance. In the next chapter, the effects of internationalization and innovation on firm performance will be discussed in detail.

CHAPTER THREE

BUSINESS PERFORMANCE

3.1. FIRM PERFORMANCE

Kanter and Brinkerhoff (1981: 321) defined the firm performance as "the degree of organizational effectiveness". The multidimensional nature of firm performance increases its complexity of measurement and also makes the generalization of the studies difficult (Ventkatraman and Ramanujam, 1986: 801; Neely, 2002: 1). As the profitability is the primary existing reason of firms, a number of studies employ firm performance to find out how companies can achieve the highest profitability and also to what extent organizational and environmental issues can hamper or boost the firm performance (Ginsberg and Ventkatraman, 1985). The performance measurement tools have been evolved since the globalization affects the operations of the firms. For instance, the level of competition made the sustainability issue of firms emerge (Hopkins, 2009). Firms used to focus on only doing the right things but not doing it right. The organizational structure, human resource issues such as employee satisfaction, market share due to high levels of competition in the global arena, customer satisfaction, technological capability, quality management in products and services became one of the most used factors to determine how successful the firm operates in the market. In the literature, the firm performance is widely analyzed in terms of financial, marketing and operational aspects (Neely, 2002: 1).

Financial based performance is the indicator of to what extent a firm fulfills its economic goals. This indicator is the most used model in empirical studies (Hofer, 1983). Firms use those measurement tools to see the level of efficiency and effectiveness they achieve in their use of resources so as to transform the inputs into valuable outputs. The main and mostly used indicators of financial performance are return on investment (ROI), return on equity (ROE), return on assets (ROA) (Lu and Beamish, 2004: 602). ROA is an indicator of how efficient the management use the company's resources (Robins and Wieserma, 1995). It is calculated as the ratio of net income to total assets. ROI is widely considered as the most appropriate

measurement for firm performance (Reese and Cool, 1978). ROI is calculated through dividing the return of an investment by the cost of that investment. ROE indicates the profitability of the company. It shows how much the company gains through the money that the shareholders invested. It is the percentage of net income to shareholder's equity.

Marketing perspective of performance, in contrast to the financial performance, is mostly based on the external factors outside the firm such as competitors and customers. Therefore, the measurement of this dimension is more subjective (Bonoma and Clark, 1988: 2). The factors used to measure the marketing performance are customer satisfaction, customer loyalty, market orientation and brand equity (Neely, 2002: 22).

Customer satisfaction plays a crucial role in explaining the market performance of the firms. Customer satisfaction has been a tool of benchmarking for firms. The drawback of this indicator is the difficulties in its measurement as customers are open to manipulation.

Customer loyalty refers to what extent a firm's customers remain customers of the same firm or how easily another firm can lure its customers away. A loss of a loyal customer is the same with a loss of an asset, since loyal customers are seen the most valuable assets of the firms (Dick and Basu, 1994). To gain the loyalty of a customer takes time. Therefore, it becomes a setback for the new firms to measure the customer loyalty.

Market orientation indicates to what extent the firm is market driven (Jaworski and Kohli, 1996). In other words, it is the level of information of the firm about the market in which it operates. In this view, the acquisition of information, transferring it within the organizational actors to use it for achieving organizational goals is of importance.

Brand equity is the indicator of the strength of the brand in the market place (Neely, 2002: 32). According to the behavioral approach, the strength is measured through the perceptions of customers about the brand and also their purchases of the products or services of that brand (Keller, 1993). The financial approach is based on the financial value of the brand (Simon and Sullivan, 1993). The measurement of the

brand equity becomes useless if the firm is new. Since creating a strong brand takes long time.

The operational perspective is the indicator of the market share, quality of services and products, and productivity. Briefly, it shows how efficiently and effectively a firm accomplishes its organizational operations in terms of quality, speed, cost, flexibility, innovation, and delivery. Buzzell and Gale (1987) claim that market share indicates the level of profitability of a firm. Productivity can be interpreted in different aspects, some authors in the literature analyze it in terms of labor productivity whereas some others focus on the total firm level productivity (Neely, 2007: 66). However, productivity is often used to indicate to what extent the firm transfers the inputs into outputs effectively and efficiently (Hayes and Clark, 1986).

In the literature, *the human resource aspect of the firm performance measurement* is also applied (Hudson et al., 2001: 1006). The human resource dimension focuses on the working environment in terms of culture. It is based on the educational level of the employees, their teamwork, the relationships within the organization and the competencies of the employees (Kaplan and Norton, 1992). Those measurement factors are the guidelines for the firms as they are in the search of more effective and efficient ways to value their both physical and intellectual assets, increase their profitability and productivity through customer and employee satisfaction. Those indicators are the results of their already ended efforts and also the predictors of their future commitments.

3.2. THE ASSOCIATION BETWEEN FIRM PERFORMANCE AND INNOVATION

In the literature, innovation has been meant to be "the idea of anything new that a firm adopts in the aim of achieving a superior organizational performance" (Camisón-Zormoza et al., 2004). Those changes can be in terms of any structure, policy, device, and employee training programs, a product, service or strategies (Damanpour and Gopalakrishnan, 2001: 47). In an economic aspect, innovation is a commercial transformation of ideas into commercial assets which can be any new or

modified products, processes or systems which are the key issues of being able to remain competitive and profitable in the global arena (Gunday et al., 2011: 662; Roper and Love, 2002: 1087).

A number of studies showed the boosting power of innovation on both national economy and the firm performance (Weerdana et al., 2006; Thornhill, 2006; Li and Atuahene-Gima, 2001; Walker, 2004). However, there is still no clear conclusion made on the association between the firm performance and innovation in the literature (Hughes, 2001: 161). A review conducted on the relationship between firm performance and innovation concludes as this relationship can be controversial (Li and Atuahere-Gima, 2001: 1123).

Innovation is considered as the engine of national economy and firm growth, since innovation activities trigger the level of the competition and increase the demand. By the same token, governments worldwide are spending a great deal of concern so as to boost the innovation in the country level (Neely et. al, 2001: 114).

According to Resource Based Theory, firms cannot survive without their intangible assets with their giant global competitors (Barney, 1991). Innovation is considered as the key to the success and survival of the firms in the international arena where the rules of the game is changing everyday due to the cutting-edge technology (Schumpeter, 1942). Under those circumstances, firms are subject to make huge investments on innovation to acquire valuable intangible assets to maintain their presence in the market place (Zahra and Covin, 1995). Those intangible assets acquired from innovation activities are the competitive advantages of the firm which help the firm stand out from the others . Firms can only sustain their market position in the market through the new innovations since the technology made the product life cycles shorter than ever. In addition, firms are subject to continuously innovate in order to achieve long-term success. The unique products, processes, services provide the firms enjoy excessive profits (Schumpeter, 1934).

Through innovation, firms produce highly valuable products and enjoy low-cost production, which in turn, enhances the organizational performance (Mole and Worrall, 2001: 356). Adoption of any appropriate innovation provides firms to respond to quick changes in the market and react before the competitors (Zahra and Covin, 1995). Firms can be first mover with their radical innovations and enjoy high

market shares and profits (Damanpour et al., 2009: 656). Innovative firms can increase their sales by attracting customers with their unique and valuable products in the market (Mole and Worrall, 2001: 360). Moreover, they can achieve high brand loyalty through unique products offered. However, the returns of innovation may take long, thus firms may not experience the high profits for some time (Damanpour and Evan, 1984). This overdue return may indicate that the acquisition of customer satisfaction through new products or low-cost production through new process innovations needs long time to reflect on the performance (Gunday et al., 2011: 665).

Deshpande et al. (1993) found that innovation triggers the organizational growth. However, this effect may differ regarding to the industry. Take for instance, a study made on Australian firms in service and manufacturing sector, indicates that the correlation between innovation and performance is stronger in manufacturing firms than the firms in service industry (Prajogo, 2006: 222).

A meta-analysis by Rosenbuch (2011: 441) covering 42 empirical studies with the number of 21.270 firms shows that innovation has a positive effect on firm performance. This effect is stronger in young firms, which may be due to the rapid response capability of the new firms to changes compared to the old established firms. In contrast, Jimenéz and Salz-Valle (2011: 413) found that innovation activities of the manufacturing firms enhance the firm performance but this relationship is stronger in old and large firms.

Mansury and Love (2008) found that service innovation has a positive effect on firms' growth. Some researchers assert that adoption of only a certain type of innovation may not be enough to achieve superior performance (Azar and Drogendijk, 2014: 596). Instead of focusing on only one type or only technological aspect of innovation, Damanpour et al. (2009: 656) applied the four main types of innovation in their study conducted in the UK and made a conclusion which states that adoption of different innovation types simultaneously will boost the firm performance continuously whereas the positive effect of undertaking one type of innovation lasts only for a while. Gunday et al. (2011: 672) conducted a study which showed the positive effects of the four types of innovations' positive effect on firm performance and made a conclusion that managers should be aware of the boosting power of innovations on firm performance.

To sum up, through innovation, firms can gain competitive advantage which results in high returns, and with those high returns, firms will continue to innovate in order to keep pace with the developments in the market or to achieve a sustainable competitive advantage. Although the firm has the first mover advantage in the market, if it does not follow a continuous innovation strategy, the failure is inevitable. As can be understood, the long-term performance of internationals is based on the innovation activities they carry on (Hitt et al., 1997: 770).

In contrast to the studies showing a positive relationship between innovation and firm performance, there are some authors claiming a negative or no association at all (McGee et. al, 1995; Vermeulen et al., 2005; Chandler and Hanks, 1994; Subramanian and Nilakanta, 1996; Birley and Westhead, 1990). It is claimed that unless the innovation results in effective outcomes such as better delivery, lower production costs, the returns of those innovation adoptions can decrease the firm performance (Womack et al., 1990). As innovation harbors a high risk of failure, the management of this process should be undertaken thoroughly. Simpson et al. (2006) claim that as innovation is risky and costly, its positive returns can increase the performance in a great deal but if not, the hazards of this risky investment takes long to recover for firms especially the ones with resource constraints, and also they risk their market position with this failure. The failure of the innovation adoptions are usually resulted from the managerial constraints. In addition, the imitation of innovations can decrease the positive effect of the innovation and even it may become negative.

Firms may not experience the expected return of their innovation investments due to the appropriability problems in the region. If the policies and regulations are not sufficient to protect the innovator, the imitators will lure the innovator's sales, which usually results with a decrease in performance (Geroski, 1995). Thus, however, firms can engage in innovation activities there is no guarantee that the returns of innovation investments will be positive. The relationship between innovation and firm performance is vulnerable to any effects related to external or internal environment of the company, such as low appropriability or managerial constraints to coordinate the operations.

3.3. THE ASSOCIATION BETWEEN FIRM PERFORMANCE AND INTERNATIONALIZATION

Internationalization as a growth strategy is supported by a number of theories since it triggers not only the firm growth in terms of turnover and employment but also the financial performance of the firm. As Buckley and Casson (1976) claim that the main reason for firms to internationalize stands for the cost reduction through transferring the resources from overseas markets where they are cheaper compared to their home markets. Firms can achieve higher profits through taking advantage of locations where harbor, for example, low-cost wages, low cost raw materials, better but cheaper transportation facilities (Dunnig, 1979). According to Hymer's view (1960), firms engage in foreign direct investment (FDI) so as to gain monopolistic advantages through their valuable assets and take advantage of locational advantages. Internationally diversified firms can have a bargaining power through taking advantage of market imperfections, such as differences in resource availability of nations, building networks and a worldwide brand image.

Internationalized firms can enjoy the cost efficiency through economies of scale and scope since they mass produce and sell their products to a number of countries. In each new market, they learn and innovate to adapt to the market (Yang and Driffield, 2012: 24).

Internationalization provides firms to recognize the opportunities in the world markets, as those opportunities are of importance for high levels of profits (Rugman, 1980). Moreover, as firms expand their overseas operations, they will become more knowledgeable about the markets and more experienced, this is one of the unique competitive advantages that stand out the firm from its rivals. The more familiar the firm becomes to the markets, the lower the failure possibility becomes and the more resource commitment the firm engages, which results in high level of gains (Johanson and Vahlne, 1977). In addition, international experience increases the flexibility level of the firm since in each different market, they need to adapt new strategies such as promotion, distribution, language, and business practices and so on. This adaption makes the firm alert to all changes in the markets and responds before its rivals (Pangarkar, 2008: 477).

Despite a number of benefits internationalization hosts, there are some costs firms need to undertake. Firms view internationalization as a tradeoff between costs and benefits (Almodovar and Rugman, 2014: 6). Unless the benefits outweigh the costs, firms' profitability will decrease. Those costs are due to the lack of knowledge about the markets that are distant geographically or in perception. Each market has its own features in terms of government regulations, business practices, language, and distribution and so on. Firms need to adapt themselves to those differences in each country. Due to those factors, they undertake costly activities so as to gain information about the market, build trustworthy relationships, facilitate transportation, and coordinate activities. As the operations expand across other markets, the coordination and management of those operations becomes tougher and costly. The number of suppliers, customers, governmental bodies and middlemen to deal with and also new employees to train increase the complexity and the cost. Firms should have special competences to overcome those challenges. They have to be able to coordinate their operations in worldwide markets (Lu and Beamish, 2004; Hitt et al., 1997: 772). The point where the costs of the operations exceed the level of managerial ability, is the threshold (the turning point) at which the company begins to make loss. Thus, internationalization demands a number of firm-specific advantages to overcome the costs and make profit in the end. It is not a task to manage without those means, take for instance the innovative capabilities and marketing capabilities of the firm. The most responsible body in the firm to achieve success is the management, since they are the ones making crucial and efficient decisions to exploit the resources, take advantage of the opportunities of market imperfections through the firm's competitive advantages with the choice of right strategies.

Due to the number of ups and downs the internationalization harbors, the relationship between firm performance and degree of internationalization may differ among firms. However, Li (2007) asserts that the conflicting results of studies are due to the methodological differences whereas Hitt et al. (1997: 768) claim that the relationship between internationalization and firm performance is not as simple as it is seen. Due to its complex nature, the results are mixed. Thomas and Eden (2004: 90) argue that the results are various since authors may interpret the meaning of

internationality in different ways. Those different perspectives are the breadth and the depth of internationalization (Hsu and Boggs, 2003: 27).

The breadth of internationalization refers to what extent the firm has dispersed operations across markets (*country scope*) (Goerzen and Beamish, 2003). The depth of internationalization refers to the extent a firm involves in overseas operations (Annavarjula and Beldona, 2000). The ratio of the foreign sales or the number of employees working in foreign operations is used to measure the depth of internationalization (Ramaswamy, 1993). However, it is mostly measured by the ratio of foreign sales (Sullivan, 1994: 328). All those different ways of measurement result in different type of relationships between firm performance and internationalization.

Ramaswamy (1993: 145) measured the internationalization in terms of the number of plants in markets outside the home market and found a positive relationship. However, Goerzen and Beamish (2003: 1300) found a negative relationship between the ratio of foreign-total sales and firm performance whereas a positive relationship between the number of countries and the firm performance was found. A similar claim was made by Yang and Driffield (2012: 36), according to the meta-analysis they conducted; the relationship between internationalization and firm performance is negative when measuring the ratio of foreign sales to total sales but if it is measured by the number of foreign assets, there is a positive relationship. Due to the complex nature of internationalization, some authors claim that when it is measured, using only one dimension may be misleading (Thomas and Eden, 2004: 94).

Another issue to be considered is the length of time during which the relationship between internationalization and business performance is observed since the benefits of internationalization can be observed in long-term. Thus, studies observing a short-term performance are likely to be a downward trend.

Due to the reasons aforementioned, there are various results on the relationship between internationalization and firm performance. Some authors in the literature claim a positive linear (Vernon, 1971; Dunning, 1995; Grant, 1987; Daniels and Bracker, 1989), some claim a negative linear (Siddhartan and Lall, 1982; Kumar, 1984; Shaked, 1986; Collins, 1990) whereas some studies found a nonlinear

relationship which can be in a U shape (Lu and Beamish, 2001; Qian, 1997; Ruigrok and Wagner, 2003), S shape (Contractor et al., 2003; Lu and Beamish, 2004) or M shape (Lee, 2010 and Almadovar and Rugman, 2014) relationship between internationalization and firm performance.

3.3.1. The Linear Relationship

Grant (1987: 86) found a positive relationship between internationalization and performance in study covering 304 British manufacturing companies taking part in The Times 500 list. He found that internationalization has a boosting effect on the firm performance. The reasons lying on that boosting effect are considered to be a worldwide known brand name, knowledge gained through the internationalization process that can be related to technology or market, intangible assets, being alert to the opportunities in different markets and the flexibility that is gained during internationalization. Another study conducted by Hsu and Pereira (2006: 201) covering 110 firms concludes that internationalization has a positive impact on the firm performance and in addition to this; organizational learning makes this relationship stronger. Bausch and Krist (2007: 337) found a positive relationship between internationalization and firm performance based on the meta-analysis covering 36 studies.

Han et al. (1998) claimed a positive relationship between internationalization and firm performance based on the locational advantages and the ability of internationalized firms to satisfy the customers. Through locational advantages, firms can achieve for instance, low-cost production, low-wage labor which results in low-cost production and high profit levels. According to Han et al.(1998), internationalized firms can satisfy customers in home market with their unique products launched in foreign markets. They found that the internationalization level of 2643 firms from different countries including Japan, Germany, Italy, the U.K., Canada, the U.S., France, increase their firm performance.

3.3.2. The Curvilinear Relationship

A number of authors claim that the relationship between internationalization and firm performance is a complex issue. Some of them claim only one threshold (U shape) after which the costs outweigh the benefits of the internationalization and therefore the performance begins to decrease. On the other side, some authors claim that there are more than one threshold (S or M shape) firms' experience during their internationalization process.

3.3.2.1. The U Curve

Some studies found an inverted U shape whereas there are some others claiming a standard U shape relationship.

The Standard U shape: A U-shaped relationship starts with a decline in the firm performance at the initial stages of internationalization (Contractor et al., 2003: 7). This decline continues up to a point where the benefits of the internationalization outweigh the costs and firm performance starts to increase in accordance with the level of internationalization. Ruigrok and Wagner (2003: 68) handled the subject of the benefits and costs of the internationalization and claimed that international firms can reach the resources and develop skills that domestic firms cannot. However, on the other side of the coin, there are some costs that firms need to undergo, which are caused by the cultural differences, language, coordination problems between the branches of the company, transfer of the knowledge, political risks which may result in confiscation or expropriation. They claim a point called as the threshold of internationalization at which the performance starts to increase. At the first pace of the internationalization, firms experience a negative trend in firm performance as they expand their operations since firms suffer from the lack of experience in coordinating the operations between a number of countries and lack of required knowledge in unfamiliar markets. As they become experienced, their firm performance starts to increase again, which forms the U shape (Wagner and Ruigrok, 2003: 76).

The Inverted U shape: Geringer et al. (1989: 117) found that firm's performance increases at the first stage of internationalization since the resources of the firm are enough to make profit for a while. However, when the overseas operations expand, it becomes difficult to coordinate the operations and firms need more resources to carry out more operations. Therefore, the performance starts to decrease at this point which is the threshold of the process. Gomes and Ramasaway (1999: 186) found the same relationship between internationalization and performance. The process of internationalization starts with an upward trend and it increases up to a point where the complexity and cost of coordination of activities and lack of knowledge about the new markets cause the performance of the firm to decrease.

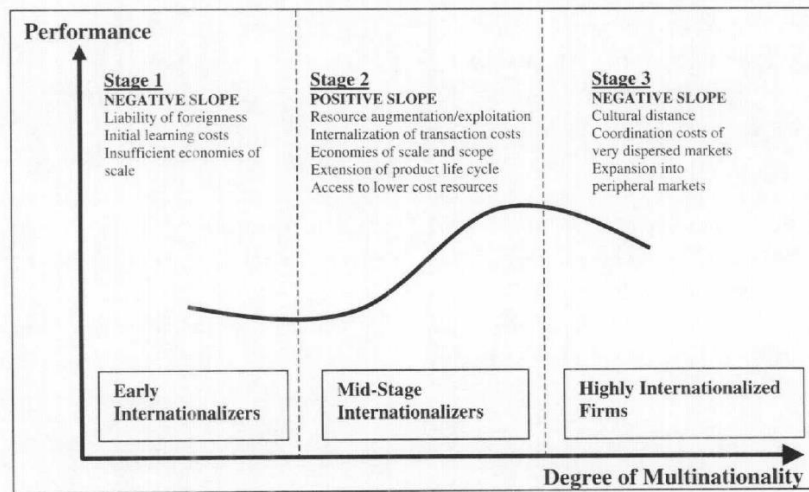
Hsu and Boggs (2003: 33) found an inverted U shape relationship between the degree of internationalization and firm performance. They claim that at the initial stage, firms' knowledge and ability are enough to handle with the hurdles or costs of the internationalization but those competencies become insufficient as the number of operations and the complexity of tasks increase. Hitt et al. (1997: 783) also found the same patterns as the low and moderate levels of internationalization are positively related to firm's performance which decreases as the degree of internationalization exceeds the optimum point and becomes extremely high.

3.3.2.2. The S Curve

Contractor et al. (2003: 8) claim a three stage model for the internationalization-performance relationship of the firms. Riahi-Belkaoui (1998: 316) claims that in the initial stage of the internationalization, firms do not make profit since their existing resources and skills are not enough to overcome the costs which can be, for example; coordination and integration of the operations. As the number of operations and geographical and perceptual distance increase, the complexity of the operations increases as well (Hsu and Boggs, 2003: 27). Thus, he claims that the first stage is costly, so it results in a downward trend in the performance. This downward trend ends where firms develop skills to take the advantages of the internationalization and the performance starts to increase again.

However, this upward trend ends at the point where the costs outweigh the benefits again. As the degree of internationalization increases, the costs to cover increases as well. In this S model relationship, as can be understood, there are two thresholds at which the direction of the relationship changes (Riahi-Belkaoui, 1998: 350).

Figure 3: S-shape Curve with Three Stages

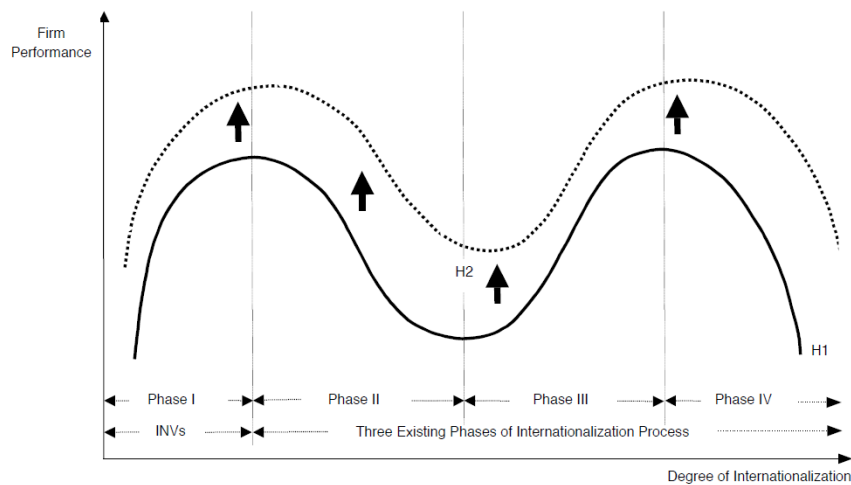


Source: Contractor et al., 2003: 7

3.3.2.3. The M Curve

The M curve relationship indicates the performance and degree of internationalization relationship of particularly internationally new ventures (Lee, 2010: 1; Almodóvar and Rugman, 2014: 10). According to Almodóvar and Rugman (2014: 10), S curve and U curve fail to explain the phases that an internationally new venture experiences. They claim a prior stage to S curve since the Born Global firms are able to take advantage of the opportunities in the market. Thus, there occurs an increase in the firm performance at the low levels of internationalization at the first stage.

Figure 4: M shaped curve



Source: Lee, 2010: 5

In addition, Ruigrok et al. (2007: 355) suggest the same relationship in their study based on 87 Swiss firms operating across markets. However, they do not make a distinction for the Born Globals. They claim that because of the nature of the home market of Swiss firms, they will not experience a low level of firm performance. Switzerland is home to four official languages and has an access to EU; this feature of the country makes difference for the Swiss firms.

The Uppsala Model (Johanson and Vahlne, 1977: 24) suggests, firms will enter the familiar markets or geographically close markets to decrease the risk of failure and achieve higher firm performance. In the case of Swiss firms, they also choose the markets familiar to them and in doing so, they do not experience low levels of firm performance at the low levels of internationalization (Arenius, 2005). This point is where the M curve differs from the S curve. After the first stage of an upward trend in firm performance, firms start to face challenges as they enter unfamiliar markets that results in low degree of performance (Hitt et al., 1997: 770). As they learn sequentially, their performance will increase since they will become more flexible, adaptable and be able to control the operations. However, this situation ends again at a point where the managerial ability is not sufficient to absorb the knowledge gained in markets and use it for operations due the complexity of

knowledge and tasks resulted in high levels of internationalization (Ruigrok et al., 2007: 356).

Merry (1995) claims that the high levels of internationalization can bring the firms in the middle of a chaos, since the number of operations or subsidiaries increases, so does the complexity. In that case firms' adaptability and flexibility are usually not enough to overcome this situation, so a decrease in firm performance is unavoidable.

To sum up, the M curve showing the relationship between internationalization and firm performance places one more threshold at which the direction of the relationship changes. At the initial stage, firms experience an increase in their performance; however, as their abilities and knowledge becomes insufficient their performance starts to decrease. Through organizational learning, the performance starts to increase at the moderate level of internationalization, which ends at the point called threshold where the operations become extremely costly and complex to control.

Despite the various types of relationship models found in the literature, the number of studies that found an inverted U shaped curve is more than the others (Yang and Driffield, 2012: 38).

CHAPTER FOUR

RESEARCH METHODOLOGY

4.1. THE OBJECTIVE OF THE STUDY

In the light of the previous topics covered, the main purpose of the study focuses on the investigation of whether entrepreneurial orientation and organizational learning stimulate a firm's internationalization and innovation activities undertaken by firms have a mediating effect on the relationship between internationalization and firm performance. This study will enhance the understanding of the effect of organizational factors on the internationalization of firms and whether the innovation activities are capable of explaining the success of the internationalized firms in overseas markets.

In general, the minor objectives of this study are as follows,

- Does the entrepreneurial orientation stimulate firm internationalization?
- Does the organizational learning have a positive effect on firm internationalization?
- Is there a correlation between entrepreneurial orientation and organizational learning?
- Does internationalization have an effect on innovation?
- Does internationalization have a positive effect on firm performance?
- Does innovation have a positive effect on firm performance?
- Does innovation mediate the relationship between internationalization and firm performance?

The overall objective of this study is to analyze the relationship between internationalization, innovation and performance. Besides, the correlation between entrepreneurial orientation and organizational learning, and the impacts of entrepreneurial orientation and organizational learning on internationalization are another focal points of the study.

4.2. HYPOTHESES

4.2.1 Entrepreneurial Orientation and Internationalization

Entrepreneurial oriented firms have an ability to recognize and exploit opportunities in new markets quicker than their competitors. Their risk taker characteristics decreases the perceived risk and makes them enter new markets (Ripolles-Melia et al., 2007: 69; Miller, 1983). They are ready to accept the further challenges and risks that new markets harbor. Firms high in proactiveness maintain their search for further opportunities in new markets and their innovative characteristics drives them to develop new capabilities that they can use in overseas markets. Therefore, we can state that,

- H1: Entrepreneurial orientation has a positive effect on internationalization.

4.2.2 Organizational Learning and Internationalization

Eriksson et al. (1997) claimed that as firms' knowledge related to the market and technology increases, their perceived risk will decrease. In addition, Johanson and Vahlne (1977) posited that experiential learning is a driving factor for firms to increase their overseas operations. As the firm gets more knowledgeable about the market, they will be willing to exploit this knowledge in new markets (Clercq et al., 2005: 411). Therefore, we can state that,

- H2: Organizational learning has a positive impact on internationalization.

4.2.3. Entrepreneurial Orientation and Organizational Learning

According to Zhao et al. (2009: 298) entrepreneurial oriented firms engage in acquisition of knowledge in order to respond the rapid changes in the market. Also, organizational learning decreases the perceived risk and allows the firm to recognize the opportunities in the market before the rivals in the market.

Thus, we can state that;

- H3: There is a correlation between entrepreneurial orientation and organizational learning.

4.2.4. Internationalization and Innovation

Operating in overseas markets enriches a firm's knowledge and enables the firm to access crucial resources (Azar and Drogendijk, 2014: 582). Through the relationships with their suppliers, customers or the actors in their networks they can access the resources that they lack. In each new market, firms learn, build or improve their abilities to innovate. In addition, to maintain their market position in highly competitive overseas markets, they need to keep pace with the cutting-edge technology and cope with the rapidly changing market conditions (Silva et al., 2010). Moreover, Piva and Vanelli (2007) found that sales in export market has a positive effect on innovation. As the international sales increase, the R&D investments of firms increase as well. Therefore, we can state that,

- H4: Internationalization has a positive effect on innovation.

4.2.5 Internationalization and Firm Performance

Han et al. (1998) claimed that highly internationalized firms can achieve great levels of performance since they take advantage of the locational advantages through which firms can achieve low cost production. Through valuable intangible assets gained in overseas markets, firms can reach superior performance compared to their domestic competitors (Grant, 1987: 86). Therefore, we can posit that;

- H5: Internationalization has a positive effect on firm performance.

4.2.6. Innovation and Firm Performance

Innovation is considered as a source of competitive advantage in overseas markets (Zahra and Covin, 1995: 45). According to Resource Based View, firms can achieve greater performance levels through those competitive advantages (Barney,

1991). Adoption of innovations make firms be able to respond quickly to the changes and alert to any opportunities in the international arena. Those innovations enable the firm to enjoy first mover advantages which is of importance in terms of superior performance (Damanpour et al., 2009: 656). In addition, Gunday et al. (2011) claim that innovation is the key to increasing market share and acquisition of competitive advantages, which results in achievement of targeted performance levels. Therefore, the study posits that

- H6: There is a positive relationship between innovation and firm performance.

4.2.7. The Mediation Effect of Innovation on the Relationship Between Internationalization and Firm Performance

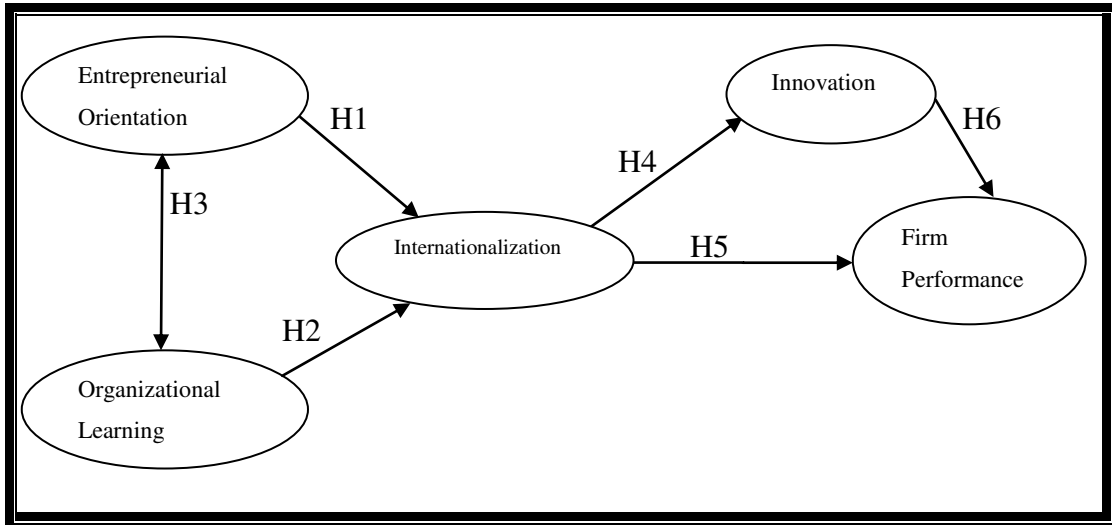
Since there is a relationship between internationalization and firm performance and also between innovation and firm performance, we can state that innovation can explain the relationship between firm performance and internationalization better. This means that firms use innovation as a strategy to achieve superior performance in international markets. Internationalization triggers innovation and innovation results in high levels of performance (Kafouros et al. 2008; Azar and Drogendijk, 2005: 582). In international markets, firms acquire competitive advantages through innovations. Those competitive advantages are the key to superior performance (Zahra and Covin, 1995: 45). Thus, we can state that,

- H7: Innovation mediates the relationship between internationalization and firm performance.

4.3. THE CONCEPTUAL FRAMEWORK

As the objective of the study was explained and the hypotheses were developed, the conceptual framework can be seen in Figure 5.

Figure 5: The Conceptual Framework



4.4. SAMPLE AND DATA COLLECTION

The unit of analysis of this study is the exporting manufacturing firms in the Aegean Region. The sample is composed of exporting manufacturing firms in textile, food, chemical and machinery sector operating in the Aegean Region. Those sectors are chosen in order to compare the low, medium, and high innovation intensive sectors. Food and textile sectors are considered as low; chemical sector is medium-tech whereas machinery sector is considered in high-tech sectors (OECD, 1992, 2005). The total number of firms operating in those sectors is 1782 according to the list provided by the Aegean Exporters' Association, but most of the information regarding the firms was stated wrong or not updated. Some of the firms changed sectors and some others do not export anymore. In addition, it was hard to find a firm which manufactures and exports simultaneously. Some of the firms act as a middlemen and they merely engage in export and import activities without any production activity. Another issue is the age of the firm, since the firms which are already five years old or older were selected. The reason lying behind this issue is that there are some questions about a firm's last five year's activities. The last thing worth mentioning is the point that the most of the firms' names in the list were stated in more than two sectors that boomed the number of the firms in the list. When the repeating names are eliminated the number of population reduced to 1522.

The data collection process lasted for a month. During the data collection process, the first step was to send a mass e-mail including the web-based survey to all the companies in the list. However, 566 of these e-mails failed to be delivered. A follow-up mass e-mail were sent to the companies for three times more. However, the number of responses reached to 10. Due to the low levels of return, the companies were called to increase the response rate. Firstly, the companies were informed about the study and it is asked to make an appointment with the qualified person for the questionnaire. The questionnaires were collected through face-to-face interviews with a manager from production, research and development or export departments as they are the most knowledgeable people in the organization about the innovation and internationalization activities undertaken.

Despite the phone calls, most of the firms rejected to have an interview and also web-based survey as they thought they revealed the company privacy. Some of them rejected due to their busy schedule whereas some staff members were in leave or away for fairs or exhibitions. Moreover, 308 firms' contact information was missing or wrong and 82 firms' do not export or manufacture anymore. Due to the constraints mentioned above, the population reduced to 556. The sample size at the end of this period reached to 82, 40 of which were obtained through web-based survey and the rest were done face to face. However, one of the answered questionnaire was eliminated due to the high numbers of missing answers. Therefore, 81 questionnaires were analyzed in this study. The sample size is very close to the lowest recommended level which is between 15% - 20% of the population (Lages and Montgomery, 2005: 766).

4.5. QUESTIONNAIRE DESIGN

A structured questionnaire was used in the study. It is composed of five separate sections placed to measure each variable in the conceptual model. Those sections are related to the entrepreneurial orientation, organizational learning, innovation, internationalization and firm performance. All variables are measured on a 7-point Likert-type scale. For the innovation scale, it ranges from 1= Incremental to 7= Radical and from 1= Limited to 7= Extensive. For the firm performance, it ranges

from 1= Much Worse to 7= Much Better. For the rest of the scale, it ranges from 1= Strongly Disagree to 7=Strongly Agree. There are also three questions about the demographic characteristics of the firm which are about size and sector type of the company.

Each section in the questionnaire was adopted from different authors' scale. This study focuses on organizational learning as a single construct comprised of four behavioral dimensions which are knowledge acquisition, information distribution, information interpretation and organizational memory. In this study the organizational learning scale of Perez Lopez et al. (2004) is adopted. The total number of items belong to organizational learning is 13.

The scale of internationalization was adopted from the study of Wolff and Pett (2006: 277). In the scale, 3 questions about a firm's current and future export activities are asked. Wolff and Pett (2006: 276) made an exploratory assessment and found a reliability score of 0.84 which indicates that the questions capture the internationalization construct.

The entrepreneurial orientation scale is based on Miller's (1983) study. Wiklund (1998) suggests that this scale is useful for measuring the firm level entrepreneurship. The scale has four dimensions which are proactiveness, aggressiveness, risk taking, and innovativeness. However, as Miller (1983) undermined the innovation propensity of firms and strengthened the technological outcome of innovation, the innovativeness dimension becomes useless (Lumpkin and Dess, 1996). Given this issue, for the innovativeness subdimension; two items from Miller and Friesen (1983) and one item from Hurt et al., (1977) were adopted. The other items were adopted from Naman and Slevin (1993). The total number of items belong to the scale is 11.

The innovation scale was adopted from Weerawardena (2003b, a). Previous studies focused on the secondary data such as number of patents or R&D expenditure (Nam et al., 2004). However, those indicators can cause biases in different sectors (Galizzi and Venturini, 2008). Nam et al. (2014) state that primary data for the innovation construct is more appropriate and accurate. Thus, this method provided us to utilize the primary data to evaluate the actual innovation activities of the firms. Moreover, the other proxy measures are considered to fail to measure innovation for

low-tech sectors (Hirsch-Kreinsen, 2008). In this study, innovation is operationalized in four dimensions which are product, process, managerial and marketing innovation which are to degree from 1 to 7 in terms of amount (limited-extensive) and novelty (incremental-radical). This scale includes 8 items.

Given the data accessibility constraints and the nature of structural equation modeling, the firm performance is based on a subjective measurement. According to some studies, the perceptual measurement is a valid approach and there is a high correlation between subjective and objective measurement (Venkatraman and Ramanujam, 1986). The scale was developed by Morgan and Strong (2003: 169). It is comprised of 7 items which include return on investment, sales growth, market share, customer satisfaction, competitive position, customer retention, and overall firm performance. The respondents were asked to compare their last three-year performance to the competitors' in the markets they operate most.

All the scales were translated from English to Turkish and a back-translation was made to see how well the translation was made. A pretest was conducted nearly for 10 firms to see whether the counterpart clearly understands the content of the questions in the questionnaire and how long it takes to answer the questionnaire. Some modifications had to be made for a more clear and better understanding. During this process, some academicians' views were taken into account for the design of the questionnaire.

4.6. DATA ANALYSIS

In this quantitative study, structural equation modeling is utilized through AMOS. In the light of the questionnaires, a snapshot of demographic characteristics of the firms is provided by using the frequency analysis. Besides, the reliability of the scales were analyzed through the Cronbach alfa values.

4.6.1 The Demographic Characteristics of The Firms

- Industrial Characteristics: The study encompasses four industries which are machinery, food, textile and chemical. The total number of

firms counts to 81. As can be seen in Table 1, nearly 40% of the firms are from the textile industry. The number is high compared to the others since the firms in machinery and food industry were quite unwilling to take part in the questionnaire. 18 firms from the food industry, 21 from the chemical industry and finally, 10 firms from the machinery industry are the elements of this analysis.

Table 1: Industrial Characteristics

Industry	Frequency	Percent	Valid Percent	Cumulative Percent
Textile	32	39.5	39.5	39.5
Food	18	22.2	22.2	61.7
Machinery	10	12.3	12.3	74.1
Chemical	21	25.9	25.9	100.0
Total	81	100.0	100.0	

- **Size Characteristics:** The size of the firm reflects the number of employees working in that firm. It is classified as small, medium and large firms. Firms with less than 49 employees are considered as small, between 50 and 249 are considered medium and, more the ones with more than 250 is considered as large firms (KOSGEB, 2012). It seems that 29 small, 30 medium and 22 large firms are the sample profile of this study (shown in Table 2).

Table 2: Size Characteristics

Size	Frequency	Percent	Valid Percent	Cumulative Percent
1-49	29	35.8	35.8	35.8
50-249	30	37.0	37.0	72.8
250 or more	22	27.2	27.2	100.0
Total	81	100.0	100.0	

4.6.2. Descriptive Statistics

Through descriptive statistics, each items' mean value will be analyzed and interpreted. In addition, the means of innovation and firm characteristics will be compared in order to see whether or not the size and industry matter in terms of innovation activities.

4.6.2.1. Innovation and Industry

In this section, the innovation activities undertaken by firms are analyzed according to their size and sector. The most product innovation intensive industry seems as the machinery sector which is technology intensive. Also, in the literature machinery (electric-electronic) sector is seen as the high-tech sector (OECD, 2005, 1997). Both number of product and process innovations are high in machinery industry compared to the others with the mean of 6.10 and 6.20 (shown in Table 3). Those values show that the number of product and process innovations are close to the extensive level since they are close to 7. Firms in machinery industry look innovative in terms of number of product and process innovations. The novelty of product and process innovations score to 5.60 and 5.80 which show that firms engage in radical innovations in a moderate level. It can be inferred that the innovations are not greatly radical since it does not score to 7.

Although, in the literature textile is considered as a low-tech sector, in this study, this sector follows the machinery sector in number of product and process innovations with the mean values of 5.62 and 5.56. These values show that textile firms innovate but not in an extensive number. The novelty of product and process innovations score to 5.19 and 5.44 which show that firms engage in radical innovations in a moderate level since it does not score to 7. According to the respondents, time is a big issue for both firms in machinery and textile sector, they want to serve for more customers in a short time period that is why they put emphasis on process innovations. This may be the explanation of the process innovation values.

The mean values of the number of product and process innovations for the chemical industry scores to 4.52 and 5.10 whereas these values for the food industry are 5.39 and 5.50. It seems that firms in the food industry are more innovative than the chemical firms.

All in all, firms operating in the chemical industry show the lowest level of product and process innovations. However, they still look innovative with the mean value of 4.52 for amount of product innovation since it exceeds the normal level which is 4.

As can be seen in Table 3, all sectors do not put great emphasis on managerial innovation as much as the others except the food sector. It can be due to the family ownership of the companies since almost all the companies in this study were family business. The highest mean value of the number and novelty of managerial innovations score to 5.00 and 4.78 which are in the food sector. It can be inferred as firms in the food industry engage in managerial innovations but not in an extensive number and also firms in the food sector place innovations but those innovations are not big changes in terms of novelty since it does not score to 7. This result may indicate that firms in food sector may be becoming large firms or increasing their operations. Those changes in the firms require new adaptations. The lowest values are 3.62 and 3.43 which are in the chemical sector. Firms in this sector put emphasis on managerial innovations in a very low level.

The marketing innovations seem high in food and machinery industry. The firms in the food industry engage in new ways of packaging and distribution that can

be the reason of these values. Especially, distribution is vital for firms that sell fresh fruit and vegetables. This can be explanation of the mean value of 5.22 for the number of marketing innovations in the food sector. This value for the machinery industry scores to 5.20 which shows that firms in the machinery sector put emphasis on this innovation type. Moreover, the novelty of marketing innovations are high the machinery and food sector.

All in all, the means of the all types of innovations show that amount of process innovation is the first priority of the firms with the overall mean of 5.51. This is expected since all the firms in the sample are manufacturers. The lowest value of the general mean is the managerial innovations, also most of the respondents mentioned about this absence in their firms. Take for instance, an elevator company which is a family owned company became a large company recently. According the production manager, he use to act like a both human resource manager and also a production manager since the owners of the company were not willing. But once their number of workers exceeded 249, they had to place a Human Resource Department.

To see the statistical difference between industries , ANOVA test is applied. It is found that there is only a statistical difference between industries in number of product innovations at $p < 0.05$ level. The p value scores to 0.022. The other amount and novelty of innovations are found not statistically different at $p < 0.05$ level which means all the firms in each sector conduct nearly same amount and same level of novelty of innovations except the number of product innovations.

Table 3: Industrial Comparison of Mean Values of Innovation

INDUSTRY		AMOUNT OF PRODUCT INNOVATIONS	NOVELTY OF PRODUCT INNOVATIONS	AMOUNT OF PROCESS INNOVATIONS	NOVELTY OF PROCESS INNOVATIONS	AMOUNT OF MANAGERIAL INNOVATIONS	NOVELTY OF MANAGERIAL INNOVATIONS	AMOUNT OF MARKETING INNOVATIONS	NOVELTY OF MARKETING INNOVATIONS
TEXTILE N= 32	MEAN	5.62	5.19	5.56	5.44	3.97	4.22	4.75	4.50
	SD	1.581	1.693	1.458	1.564	2.087	2.151	1.566	1.666
FOOD N= 18	MEAN	5.39	4.83	5.50	5.00	5.00	4.78	5.22	5.17
	SD	1.539	1.886	1.654	1.815	1.495	1.801	1.215	1.249
MACHINERY N= 10	MEAN	6.10	5.60	6.20	5.80	4.30	4.20	5.20	5.10
	SD	1.101	1.174	.919	1.033	2.214	2.098	1.135	1.197
CHEMICAL N= 21	MEAN	4.52	4.52	5.10	4.95	3.62	3.43	4.62	4.76
	SD	1.436	1.778	1.895	2.085	1.746	1.777	1.627	1.670
OVERALL N= 81	MEAN	5.35	4.99	5.51	5.26	4.15	4.14	4.88	4.79
	SD	1.550	1.714	1.582	1.716	1.931	1.998	1.461	1.531
F- test		3.384	1.138	1.133	.801	1.865	1.549	.790	.881
Sig.		.022	.339	.341	.497	.143	.209	.503	.455

4.6.2.2. Innovation and Firm Size

The relationship between firm size and innovation is a never ending issue. The confrontations on this relationship still keep continuing, as it was discussed in earlier sections. As can be inferred from Table 4, large firms are slightly more innovative. Take for instance the mean value of number of product innovations score to 5.73 which is the highest value among the others. It can be inferred as the large firms put importance on product innovations since the mean value is close to 6.

Especially, the managerial innovations are higher in large firms which score to 4.82 for the amount and 4.59 for the novelty. As the firms get larger, they undergo some changes. It can be interpreted that all the firms in each sector do not engage very big changes in terms of managerial issues.

As it can be seen in table 4, small firms focused on product and process innovations. The amount of product innovations scores to 5 whereas the process innovations scores to 5.28. The managerial innovations score to 4.00 which is lowest value for the small firms. The small firms in this study engages managerial innovations but in a low level.

The medium-sized firms seem to have the lowest levels of managerial innovations among the small and large firms with the mean values of 3.80 and 3.93. They engage in those activities in a low level.

The general overview shows that large firms engage more innovation activities with higher levels of novelty compared to the small and medium sized firms. It is expected since large firms have enough resources to engage innovation activities to be flexible for every rapid changes in the environment and also they serve for different customers in different countries for all of them they have differentiated products to remain their market shares. However, when the ANOVA test is applied, it is found that size does not matter to the innovation activities. There is no statistical difference between groups of different firm size which can be interpreted as small, medium and large firms do not differ in terms of number and novelty of innovations engaged.

Table 4: Size and Innovation

FIRM SIZE		AMOUNT OF PRODUCT INNOVATIONS	NOVELTY OF PRODUCT INNOVATIONS	AMOUNT OF PROCESS INNOVATIONS	NOVELTY OF PROCESS INNOVATIONS	AMOUNT OF MANAGERIAL INNOVATIONS	NOVELTY OF MANAGERIAL INNOVATIONS	AMOUNT OF MARKETING INNOVATIONS	NOVELTY OF MARKETING INNOVATIONS
SMALL	MEAN	5.00	5.00	5.31	5.28	4.00	4.00	4.59	4.52
N= 29	SD	1.604	1.581	1.734	1.688	1.871	1.871	1.476	1.550
MEDIUM	MEAN	5.40	4.70	5.57	5.23	3.80	3.93	5.03	4.90
N= 30	SD	1.567	1.950	1.501	1.888	2.058	2.196	1.326	1.322
LARGE	MEAN	5.73	5.36	5.68	5.27	4.82	4.59	5.05	5.00
N= 22	SD	1.420	1.529	1.524	1.579	1.736	1.894	1.618	1.773
OVERALL	MEAN	5.35	4.99	5.51	5.26	4.15	4.14	4.88	4.79
N= 81	SD	1.550	1.714	1.582	1.716	1.931	1.998	1.461	1.531
F - test		1.420	.952	.374	.005	.943	.787	.890	.740
Sig.		.248	.391	.689	.995	.150	.459	.415	.480

4.6.2.3. Organizational Learning Mean Values

According to the answers gathered during the study, the overall mean is close to 6 (shown in Table 5) which indicates that in general, firms put importance on learning within the company since 6 indicates the answer "agree".

The first dimension is the knowledge acquisition which is composed of three items. The first question which enquires to what extend the employees participate in fairs and exhibitions scores to a mean value of 5.88. This value is close to 6, it may be claimed that firms value exhibitions but not fully since it still does not score to 7. During the interviews, managers or owners stressed the importance of fairs and exhibitions for them. In those activities, they acquire new ideas, find new customers and make new networks.

Having a resourceful R&D policy mean scores to 5.41 which indicates that firms have a resourceful R&D policy but not in an great level since it is not 7. The R&D policy of the firm was claimed to depend on the owner of the company in small firms. Especially, in family businesses, those decisions are made between family members. It can be the reason of not having a high mean value. In addition, it can be due to the financial constraints since R&D activities are usually costly.

Testing new ideas and approaches scores to 5.78 from which it can be inferred that in general, firms value or support new ideas but not strongly. It may be due to the high levels of hierarchy in the organization. All in all, the Knowledge Acquisition dimension has a general mean value of 5.69 which indicates that the individuals in the firm acquire knowledge close to high levels.

The second dimension is the knowledge distribution which is composed of three items. The first question based on information sharing mechanisms scores to 5.60 which indicates that firms put importance in sharing information within the firm since the value is close to 6 which stands for the answer "agree". According to the some respondents, in their companies weekly meetings take place in order to provide information sharing between departments within the company. In those meetings, they share their experiences and ideas. The second question which is on interaction between individuals or departments within the firm scores to 5.75. It means that there exists an interaction between different departments or individuals and those

interactions are built through some middlemen but this still needs to be developed since the value is not 7. According to the respondents, especially in small firms the interaction between departments are poor but this situation is vice versa in the large firms. The third question is on the employees' recommendations. Especially the respondents in small family firms claimed that employees' recommendations are undermined. The mean value of this question is 5.69 which indicates that firms put emphasis on the employees' ideas but not fully. This may be due to the high levels of hierarchy in the organizations. To sum up, the knowledge distribution dimension scores to 5.68 which is close to 6 which means individuals share and distribute knowledge gained within the firm. It would be said that the knowledge acquired by an individual in the firm could reach to every individual, if this mean value scored to 7.

The third dimension is the knowledge interpretation. The first question based on shared vision scores to 5.64 which indicates that the workers in the company share a common aim but in a moderate level. This may be due to the low motivation provided by the firms for their employees. The second question which focuses on the interaction between employees scores to 5.81 which is close to 6. Thus, it can be claimed that the employees transfer their experiences and information through the face-to face interactions. The last item focuses on teamwork and scores to 5.60. Therefore, it can be inferred that companies place teamwork but not in a great level. The general mean value of knowledge interpretation scores to 5.68 which indicates that knowledge is interpreted to be more useful by the individuals in the firm.

The last dimension is the organizational memory. The first question's mean value is close to 6 which indicates that firms keep their customer database updated. According to the respondents, they have their customers' information even they are not in touch for a long time. Also all companies keep all information about everything available in files in order to reach the information whenever needed. The value scores is 6.10 which is an indicator that companies put importance on keeping information they have. The general data base are also kept updated since this value scores to 6.26. The overall mean value for the organizational memory is 6.15 which indicates that firms in general put emphasis on the storage of the knowledge and they keep the information within the company.

Table 5: Organizational Learning Mean Values

Questions for each Dimension	Mean	Std. Deviation
Knowledge Acquisition	5.69	
The employees regularly attend fairs and exhibitions.	5.88	1.391
There is a consolidated and resourceful R&D policy.	5.41	1.738
New ideas and approaches are experimented continuously.	5.78	1.225
Knowledge Distribution	5.68	
The company has formal mechanisms to guarantee the sharing of the best practices among the different fields of the activity.	5.60	1.366
There are individuals within the organization who take part in several teams or divisions and who also act as links between them.	5.75	1.260
There are individuals responsible for collecting, assembling and distributing internally employees' suggestions.	5.69	1.497
Knowledge Interpretation	5.68	
All the members of the organization share the same aim to which they feel committed.	5.64	1.307
Employees share knowledge and experiences by talking to each other.	5.81	1.085
Teamwork is a very common practice in company.	5.60	1.310
Organizational Memory	6.15	
The company has up-to-date databases of its clients.	5.99	1.346
The company has directories or e-mails filed according to the field they belong to, so as to find an expert on a concrete issue at any time.	6.10	1.147
Databases are always kept up-to-date.	6.26	.919
There is access to organization's databases and documents through some kind of network.	6.11	1.235
Overall	5.82	1.290

The overall mean value of the organizational learning scores to 5.82 so it can be claimed that firms in this sample learn through the process of acquisition, distribution, interpretation of knowledge and lastly keeping this knowledge within

the organization. Moreover, since this value exceeds 4, it can be claimed that every individual act as an learning agent which means knowledge gained individually is delivered to the others in the firm and through interpretation the knowledge becomes useful and is kept ready for further usage. If this score was 7, it could be claimed that this process was thoroughly undertaken.

4.6.2.4. Entrepreneurial Orientation Mean Values

This scale is composed of 4 sub-dimensions. The first dimension is the market proactiveness which has 3 items. The first item which asks about the managerial attitude toward technology and innovation scores to 6.11 (shown in Table 6) which means generally speaking, top managers favor technology and innovation. The second item is on the variety of new products and services that scores to 5.53 which means firms launched various new products and services in a moderate level. The third item is a cross-check question of the second item to remain the consistency that scores to 5.58. The overall mean value of the dimension is 5.74. which means firms in the sample are market proactive but not in high levels.

The second dimension is the competitive aggressiveness composed of 2 items. The first item scores to 5.51 which means the firms seem to lead the competition in a moderate level. That means they may not always the leader or there are some other leaders. The second one focuses on the competitive posture 5.63 which shows that the firms seem competitive but they are not showing a very decisive posture since the value does not score to 7. The overall dimension's mean value of the dimension is 5.57 which shows that firms do not have a very aggressive competitive posture. It may be due the low competition in their sectors.

The third dimension is the risk taking composed of three items. The first item in on to what extent the managers are prone to risky projects that scores to 5.12 which means the managers in the sample can be risk takers but not always. They have a moderate level of propensity to undertake risky projects. The second item focuses on bold actions undertaken by the management that scores to 5.36 like the first item it can be still claimed that they do not take very risky actions. The third item actually confirms the first two items as it scores to 4.65 which means firms can

wait and see posture sometimes and they are not always the risk takers by being the first mover. They can be sometimes the follower. The overall mean value of the risk taking dimension is 5.04 which is the indicator that firms in the sample do not undertake very risky actions or their propensity to take risks is not in high levels.

The last dimension is the innovativeness composed of three items. The first item which enquires the adoption of innovations as a reaction to the competitors scores to 5.49. It can be claimed that firms do not show a very innovative posture toward their competitors. The fifth item that enquires the firm willingness which scores to 5.78 and this value is very close to 6. It can be inferred that firms are willing to undertake innovation activities but still they are very willing to innovate. According to the one of the respondents they are always ready to undertake whatever new in the market place, however, their financial issues may not let them so sometimes. The last item that asks whether the firm supports its employees' original ideas scores to 5.27. This value indicates that the company places low level of empowerment. It can be due to the number of family businesses in the sample. According to the respondents working in family owned companies, generally their ideas are not fully taken into account. The overall mean value of the innovativeness dimension scores to 5.51 which shows that firms seem innovative but this posture is not strong as it does not score to 7. It may be due to the customers of those firms since some respondents claim that they only innovate if their customers demand so otherwise they do not innovate.

Table 6: Entrepreneurial Orientation Mean Values

Questions	Mean	Std. Deviation
Market Proactiveness	5.74	
Top managers favor a strong emphasis on R&D, technological leadership, and innovations.	6.11	1.000
In the past 5 years, our organization has marketed a large variety of new lines of products and services.	5.53	1.492
In the past 5 years, changes in our production or service lines have been mostly minor nature. (reverse coded)	5.58	2.058
Competitive Aggressiveness	5.57	
In dealing with competitors, our organization often leads the competition initiating actions to which our competitors have to respond.	5.51	1.450
Our organization typically adopts a very competitive posture aiming at overtaking the competitors.	5.63	1.346
Risk Taking	5.04	
In general, the top managers of my organization have a strong propensity for high-risk projects.	5.12	1.592
The top managers believe that bold, wide-ranging acts are necessary to achieve organization objectives.	5.36	1.503
When there is uncertainty, our organization typically adopts a "wait and see posture". (reverse coded)	4.65	1.769
Firm Innovativeness	5.51	
Management actively responds to the adoption of 'new ways of doing things' by main competitors.	5.49	1.276
We are willing to try new ways of doing things undertake and seek unusual, novel solutions.	5.78	1.151
We encourage people to think and behave in original ways.	5.27	1.666
Overall	5.46	1.482

4.6.2.5. Internationalization Mean Values

In this scale the first item asks whether exporting is a desirable task for the company. The mean value of this item scores to 6.38 which indicates that firms are willing to export. The second question scores to 6.43 which indicates that firms are willing to increase their export sales. Those results are not surprising since almost all companies in this study view internationalization as their reason for existing in the market place and aim to increase their export sales as much as they can afford. The score for the international trade agreements' effect is 5.75. This mean value indicates firms view that international trade agreements do not play a big role in the operations.

Table 7: Internationalization Mean Values

Questions	Mean	Std. Deviation
Exporting is a desirable task	6.38	1.146
Planning to export more	6.43	1.060
International trade agreements' effect	5.75	1.662
Overall	6.18	1.290

4.6.2.6. Business Performance Mean Values

The perceptual evaluation of managers or owners with a comparison to their major rivals in the market where they operate mostly show that from a general aspect, the respondents view their companies a little bit better than their rivals according to the findings shown in Table 8. However, as can be seen in Table 8, there are some firms that see themselves in a much worse position when comparing to their rivals.

The highest score in the table is customer satisfaction. It is expected since the common answer of the drivers of innovation is customer satisfaction according to the respondents. Take for instance, a paint company made a huge investment on colorant

which it used to import from China. The company's customer did not want Chinese colorants this made the paint firm go through a process of producing colorant which is the raw material of the paint. All those things were done for making the customer satisfied.

Table 8: Business Performance Mean Values

Questions	Min.	Max.	Mean	Std. Deviation
Market share	1	7	5.36	1.399
Customer satisfaction	2	7	5.68	1.059
Competitive position	1	7	5.37	1.373
Customer retention	3	7	5.62	1.032
Sales growth	2	7	5.46	1.361
Return on investment	2	7	5.36	1.477
Overall firm performance	1	7	5.41	1.473
Overall	1.71	7	5.46	1.310

4.7. STRUCTURAL EQUATION MODELING

For data analysis, the structural equation modeling is utilized. The feature that differentiates this model from the others is to reveal the causal relations existing between dependent and independent variables. The most important feature is it tests to what extent the sample is appropriate to the conceptual model (Schumacker, 2004: 4).

In this concept, firstly, the confirmatory factor analysis is applied to the scales to test how well each item explains the scales used. The last step is to test the hypotheses in the conceptual model.

4.7.1. Confirmatory Factor Analysis

Through confirmatory factor analysis, it can be analyzed to what extent the latent variables are explained by the observable variables in the conceptual model (Hair et al. 2014: 602). The analysis shows the regression coefficients and statistical significance level of each observable variable in explaining the latent variables (shown in Table 9).

Table 9: Confirmatory Factor Analysis Standardized Factor Loadings

Items		Sub-dimensions	Estimates	P Value	Reliability
Organizational Learning					0.925
KA1	<---	Knowledge Acquisition	.860	***	
KA2	<---	Knowledge Acquisition	.909	***	
KA3	<---	Knowledge Acquisition	.745	***	
KD1	<---	Knowledge Distribution	.743	***	
KD2	<---	Knowledge Distribution	.761	***	
KD3	<---	Knowledge Distribution	.675	***	
KI1	<---	Knowledge Interpretation	.721	***	
KI2	<---	Knowledge Interpretation	.676	***	
KI3	<---	Knowledge Interpretation	.801	***	
OM1	<---	Organizational Memory	.765	***	
OM2	<---	Organizational Memory	.787	***	
OM3	<---	Organizational Memory	.615	***	
OM4	<---	Organizational Memory	.893	***	
Entrepreneurial Orientation					0.897
MP1	<---	Market Proactiveness	.722	***	
MP2	<---	Market Proactiveness	.804	***	

Items		Sub-dimensions	Estimates	P Value	Reliability
MP3	<---	Market Proactiveness	.320	***	
CA1	<---	Competitive Aggressiveness	.812	***	
CA2	<---	Competitive Aggressiveness	.767	***	
RT1	<---	Risk Taking	.932	***	
RT2	<---	Risk Taking	.896	***	
RT3	<---	Risk Taking	.331	***	
INN1	<---	Innovativeness	.860	***	
INN2	<---	Innovativeness	.745	***	
INN3	<---	Innovativeness	.875	***	
Innovation					0.911
PI1	<---	Product Innovation	.993	***	
PI2	<---	Product Innovation	.762	***	
PRI1	<---	Process Innovation	.836	***	
PRI2	<---	Process Innovation	.947	***	
MNI1	<---	Managerial Innovation	.971	***	
MNI2	<---	Managerial Innovation	.911	***	
MR1	<---	Marketing Innovation	.884	***	
MR2	<---	Marketing Innovation	.963	***	
Internationalization					0.889
INT1	<---	Internationalization	.958	***	
INT2	<---	Internationalization	.989	***	
INT3	<---	Internationalization	.666	***	
Business Performance					0.947
BP1	<---	Business Performance	.714	***	
BP2	<---	Business Performance	.834	***	
BP3	<---	Business Performance	.900	***	

Items		Sub-dimensions	Estimates	P Value	Reliability
BP4	<---	Business Performance	.801	***	
BP5	<---	Business Performance	.881	***	
BP6	<---	Business Performance	.907	***	
BP7	<---	Business Performance	.921	***	
<i>Fit statistics for measurement model of 42 indicators for 14 constructs:</i>					
<i>p<0.05, CFI=0.791 ,CMIN\DF=4.185, RMSEA=0.118, AGFI=0,75</i>					

According to the results of the construct, regression estimates range from 0.331 to 0.993 (shown in Table 9). None of the items will be omitted as they are found to be statistically significant due to the their p values which are lower than 0.05 which means items explain the contents they belong to. In addition, all the correlations between dimensions are significant at $p<0.05$.

Concerning the fit values of the model, the model has a comparative fit index (CFI) value of 0.791, adjusted goodness of fit index (AGFI) value of 0.75 which are all at an acceptable level since they are close to 1 but it cannot be claimed that there is an excellent fit (Büyüköztürk et al., 2012: 271). In addition, the ratio of chi square to degrees of freedom (CMIN\DF) scores to 4.185 which is acceptable according to Sumer (2000). The root mean square error of approximation (RMSEA) scores to 0.118 which indicates not an excellent but a mediocre fit (MacCallum et al. 1996:134).

4.7.2. Reliability Analysis of The Scales

As the internal consistency is one of the crucial issues, in this study the reliability test is applied to all scales to see whether the items measure the same construct (Tabacknick and Fidell, 2007: 652). In this point Cronbach Alpha is the indicator of how well the scale works.

The reliability level of the innovation scale is found as 0.911 (shown in Table 9) which indicates that all the variables in the scale measure what it is supposed to measure. The alpha score of the organizational learning is 0.925 which indicates an excellent level of reliability whereas it is found 0.889 for the internationalization

scale. The alpha value for business performance is 0.947 whereas it is 0.897 for the entrepreneurial orientation. All the scales' reliability scores are higher than the recommended level which is 0.70. Thus, it can be claimed that, the scales used in this study are reliable (Nunnally, 1978: 245).

Given the results mentioned above, it can be claimed that there is an internal consistency in all the constructs. The items in the scales measure what they are aimed to measure.

4.7.3. Hypothesis Testing

The hypotheses that were set previously were tested by structural equation modeling through AMOS. Through structural equation modeling, it is possible to see how well the sample fits to the hypothesized conceptual model.

The normed fit index (NFI) of the model is 0.70, the lower threshold for this value is 0.80, which can be a sign of badness of fit index. The value of CFI is 0.73 and adjusted AGFI is 0.75. All these indicators are better to be close to 1 (Cokluk et al., 2012: 272). RMSEA scores to 0.128. so it seems the model shows a reasonable goodness of fit. The reason of those low values can be the lower level of correlations in the model (Kenny, 2014: 1) or the number of parameters in the model and the lower level of sample size (Simsek, 2007: 48).

As can be seen in Table 10 all the relationships except one of them in the model are significant at $p < 0.05$ level. Therefore, the second hypothesis which was on the positive effect of organizational learning on internationalization was rejected and the rests are supported.

The first hypothesis was supported. It is found statistically significant at $p < 0.05$. The standardized regression weight is found as 0.51 which means a unit change in entrepreneurial orientation causes internationalization to increase by 0.51.

The second hypothesis was rejected as it is not found statistically significant at $p < 0.05$. The regression weight is found as 0.18 which means a unit change in organizational learning causes internationalization to increase only by 0.18.

The third hypothesis on the correlation between organizational learning and entrepreneurial orientation were not rejected as their correlation is statistically

significant at $p < 0.05$. There is a positive correlation between entrepreneurial orientation and organizational learning. The strength of this relationship is found as 0.81.

The fourth hypothesis was the effect of internationalization on innovation which was not rejected. It is found statistically significant at $p < 0.05$. The regression weight is found as 0.31 which means a unit change in internationalization causes innovation to increase by 0.31.

The fifth hypothesis was the positive effect of internationalization on firm performance which is found statistically significant at $p < 0.05$. The regression weight scores to 0.40 which means a unit change in internationalization causes the business performance increase by 0.40.

The sixth hypothesis was the positive effect of innovation on firm performance. As can be seen in Table 10, it is found statistically significant at $p < 0.05$. Therefore, this hypothesis was supported. Innovation has an effect on firm performance with the regression weight of 0.58 which means a unit change in innovation causes the business performance to increase by 0.58.

Table 10: Regression Weights and Correlation

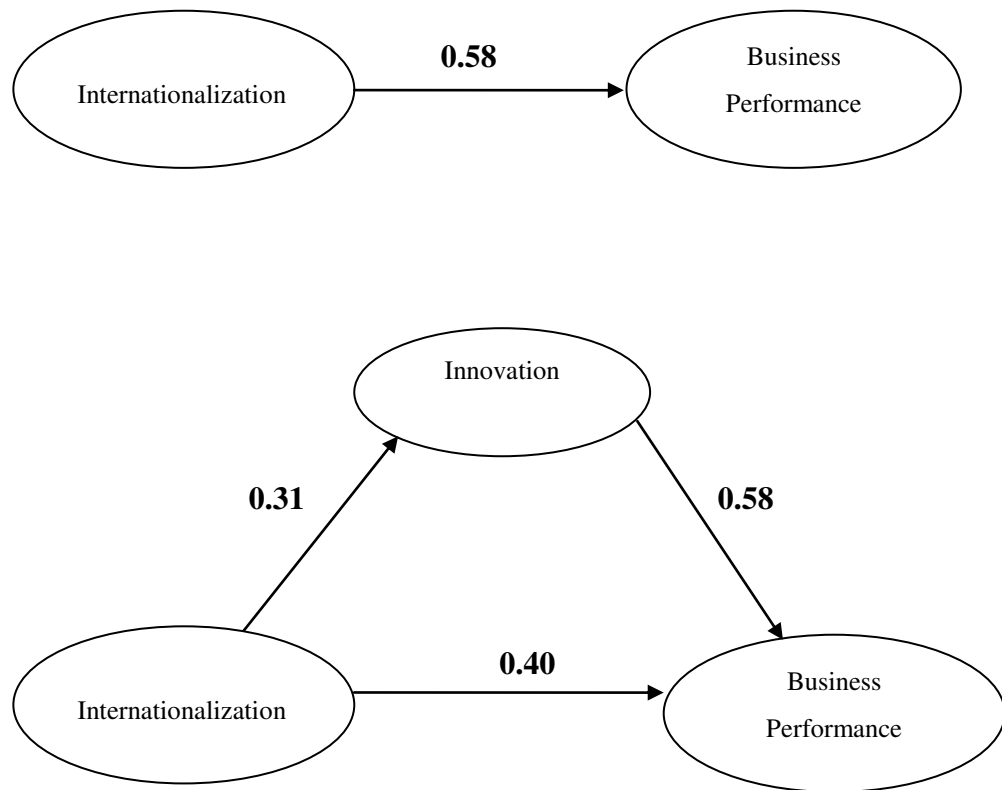
Variables		Estimate	P*
Entrepreneurial Orientation	→ Internationalization	0.51	***
Organizational Learning	→ Internationalization	0.18	.201
Entrepreneurial Orientation	↔ Organizational Learning	0.81	***
Internationalization	→ Innovation	0.31	***
Internationalization	→ Business Performance	0.40	***
Innovation	→ Business Performance	0.58	***
<i>Fit statistics for the conceptual model:</i> $p < 0,05$, $CFI = 0,73$, $NFI = 0.70$, $AGFI = 0,75$, $RMSEA = 0.128$			

The last hypothesis was on the mediation effect of innovation on the relationship between internationalization and business performance. According to Baron and Kenny (1986), there are four conditions needed to be fulfilled to claim a mediation effect. These are;

- if the independent variable already has an effect on the dependent variable,
- if the independent variable already has an effect on the mediator,
- if the mediator already has an effect on the dependent variable,
- if the regression weight of the effect of independent variable on the dependent variable decreases when the mediator is included and there is a significant effect of the mediator on the dependent variable.

The regression weight differences are shown in Figure 6.

Figure 6: The Mediation Effect of Innovation



The direct effect of internationalization on firm performance is 0.58 and it is statistically significant at $p < 0.05$. The relationship between internationalization and innovation, and the relationship between innovation and internationalization are statistically significant at $p < 0.05$ level as well. The standardized regression weight of internationalization on innovation is 0.36 whereas the regression weight of innovation on firm performance is 0.71. When innovation mediates this relationship, all the interrelations remain statistically significant at $p < 0.05$. However the effect of internationalization on performance decreases to 0.40. Therefore, it can be claimed that innovation mediates the relationship between internationalization and firm performance in a partial way. There is a partial mediation since the relationship between internationalization remains still significant, there is only a decrease in the effect of internationalization on firm performance by 0.18.

CONCLUSION

Today's global arena where harbors a never ending fierce competition and accepts no flaw but on the other hand offers a number of opportunities. Firms are in need of capabilities and resources to capture the opportunities for their survival. The mixture of those capabilities and resources are the competitive advantages of firms. When internationalizing, firms engage in a number of adaptations either strategic or practical. They are subject to adapt otherwise failure is inevitable. Survival among the rivals demands a lot. Firms undertake a number of risky operations, to create a sustainable competitive advantage that stands them out among the others. As technology has no end, the rules of the game are changing every day. A continuous improvement in terms of strategies, goods and services is the key to survival of the firms.

As knowledge became the source of success, firms make huge investments on it. Technology and knowledge became the main determinants of success in this fierce rivalry. Through acquiring and mobilizing knowledge and technological competencies, firms produce goods and services with high levels of novelty. Firms are bound to be able to keep pace with the cutting-edge technology to compete with the giant competitors. They need to produce unique goods and services, pursue unique business models, marketing strategies and organizational tools that make them outstanding.

In the light of the literature review, the conceptual model was drawn and the hypotheses were tested through structural equation modeling. In the conceptual model, there are five variables including Entrepreneurial Orientation, Organizational Learning, Internationalization, Innovation, and Business Performance. Through ANOVA, it is found that number and novelty of innovations does not differ for each industry type and firm size since they are found statistically insignificant at $p < 0.05$ except the number product innovations. Firms in the sample put more importance in product innovations than the other types. Generally, the firms in the sample claimed that they undertake innovation on customers' demand, this may be the reason why even the number product innovations reach to high levels both in terms of amount and novelty.

Through the analysis of the application on 81 exporting manufacturing firms, it is found that firms place entrepreneurial orientation ($\mu=5.45$) and organizational learning ($\mu= 5.82$) but not fully as they both do not score to 7. Those values are not in high levels it may be due to the financial reasons that may stop the firm from taking risks or the high levels of hierarchy which hampers generating new ideas or ownerships type of the firms. According to the respondents, although there is a R&D department they are not active enough since the company is owned by the family members. The conflict between those members affects all important decisions and also the all projects. In addition, the high levels of hierarchy decrease the interaction between organizational members which hampers learning. Those constraints can be the explanation of the moderate levels of both entrepreneurial orientation and organizational learning.

The overall mean value of the business performance score indicates that firms view their position a little bit better than their competitors. The value is not in excellent level, it may be due to the returns of innovation and also internationalization that need long time.

According to the overall mean value of internationalization, firms in the sample seem internationalized. Firms value their internationalized posture in the market and they want to increase their presence in the international arena. During the data collection process, some firms claim that they are trying to decrease their domestic operations to increase and focus on export operations more.

From the mean values of internationalization and business performance, it can be inferred that firms are quite willing to increase their international operations but their financial constraints and also the perceived risk may hamper their international expansion. Thus, the firms in this study may experience a sequential process as in the Uppsala Model rather than Born Globals.

Entrepreneurial flair provides firms to realize and capture the markets with full of opportunities in the right time. In addition, learning makes firms to know more about the markets and make wise judgments about the risky operations. Innovation is a tool used by the entrepreneurs in order to gain and also retain market shares in the world markets. Firms operating in those markets view innovation as a strategic key that guides to success. Innovation can be considered in many aspects,

be it entering new markets, new ways of serving mature markets, new ways of servicing, buying new machineries, employing new workers, briefly anything new happening is an innovation. All those issues play a crucial role in the internationalized firms' performances. Therefore, this study places the interrelations between entrepreneurial orientation, organizational learning, internationalization, innovation and firm performance. Through this study, it is attempted to put down to the fact which is the role of innovation in the success of the internationalized firms in machinery, chemical, food and textile industry. In addition, this study enlightens the effects of entrepreneurial orientation and organizational learning on firm internationalization. All the issues are explained in detail in previous chapters.

The effect of entrepreneurship on internationalization was found as expected. This effect would be stronger if the sample size on hand was larger. The findings are parallel with the literature. In the literature, entrepreneurs are considered as the main drivers of the firms into the international arena. The combination of wisdom, potential to innovate, energy, strong vision, enthusiastic posture results in success. Firms attended to the face-to-face questionnaire claimed that they take risk since they are aware of the reality that the more risk they take, the higher profits they get. Especially, their competitive posture makes them experience new markets since they want to enter new markets before their competitors.

The effect of organizational learning on internationalization was parallel to the literature. However, this effect is not as strong as the entrepreneurial orientation. When firms get knowledgeable about the markets, the perceived risk decreases. That situation triggers them to experience new market places. According to some respondents, firms usually learn in the international fairs or exhibitions and from their customers. Fairs are sources of both learning and gaining new networks. They also can learn from the network they are in such as their suppliers in foreign markets. From the mean values of organizational learning, those statements can be confirmed since those values are higher than 4 which indicates that firms acquire information from fairs, customers and suppliers and this information is kept within the organization for further usage.

In addition, there is also a correlation between entrepreneurial orientation and organizational learning according to the results of the study. Entrepreneurial oriented

firms may learn in each new market they enter and/or as firms get knowledgeable they may become more risk taker since learning decreases the perceived risk. Moreover, as firms learn new business practices and get more knowledgeable, they may improve their competitive posture. The experience gained in each market makes them alert to respond any rapid changes.

The effect of internationalization on firm performance is a controversial issue in the literature. However, this study supports the authors that claim a positive relationship (Han et al., 1998; Bausch and Krist, 2007). Internationalization boosts firm performance according to the results. Each market is a home of new opportunities. As aforementioned in previous chapters, internationalization offers the advantages of the economies of scale and scope. It seems that firms in this study enjoy the opportunities in the markets they operate.

The effect of innovation on firm performance is found positive. Innovation has a boosting effect on firm performance. This effect is stronger compared to the internationalization. The valuable intangible assets such as patents, unique and differentiated products or services make those innovators stand out from the other players in the rivalry. If those innovators continue investing in innovation, they will have the opportunity to create a niche in the market place.

The results show that innovation is the explanation of the internationalized firms' success in a partial way. Firms owe their success in the international markets not fully but partially to the innovation activities they undertake. The mediation is partially, there may be another variables that could explain this reason more. Also, this effect may have been higher if the sample size was larger than what was available.

From the frequency values of innovation, it can be seen that none of them reaches 6 which means firms do not fully engage in innovation activities. According to the respondents, especially small firms, they claimed that they have limited number of customers but with high profit margins, they innovate only on customers' demand. If they want any product improvements or new products then the firm engages in innovation activities. They claimed that if they do not innovate on time, the competitors are ready to lure their customers away which means a failure in the market place. Briefly, it was revealed through the analysis also from the interviews

that firms operating in the international arena owe their success partially to the innovation activities they undertake. Firms are subject to innovate if they operate in different market places. Be it at least 4Ps of marketing, they adapt all those issues to each market they enter. Take for instance, a paint company uses different pigments for the paint they produce for Iran and Morocco whereas the pigments they use for the paint they offer for Ireland is different which is all due to the different climate conditions. In other words, each market needs new strategies regarding both organization and marketing. All those changes are the obligations for firms to fulfill otherwise they jeopardize their presence both for present and for the future.

According to the results, the general view reflects that the managerial innovations undertaken by firms are undermined. It seems that firms focus on technological innovations rather than organizational innovations. The reason lying behind this issue can be firms in the sample are mostly family businesses. For instance, a manager working for 14 years for the same company claimed that organizational changes are quite exceptional situations for the firm.

This study shed light on the effects of some strategic orientations' on firm internationalization and innovation's role in explaining the success gained in the international arena. Firms operating in different markets can be successful by taking advantage of opportunities in those markets through innovation.

The Limitations of The Study

This study harbors several limitations worth mentioning. The primary limitation is the sensitiveness of the structural equation modeling to the sample size, threshold of which is considered as 200. However, in this study 82 samples could be gathered one of which was not appropriate to use. This limited sample size may have caused low levels of model fit values. The number of firms from different sectors with different sizes were not balanced which may have affected the results of the study.

Another issue is the variety of the sectors which could be more diverse for a better comparison of innovation intensity of the firms operating in different sectors.

This comparison would provide to see which sectors engage in which kind of innovations and to what extent their novelty of innovations differ.

A longitudinal perspective of this study can be better in terms of evaluating the innovation outcomes since some innovation investments can take long time to enjoy or suffer the results. In addition, the business performance scale was based on the perceptual evaluations of the managers which can be biased. Therefore, a more objective measurement can be utilized.

In this study, the boosting effect of internationalization on firm performance and the mediation effect of innovation on this relationship are found. A further study can focus on a reciprocal relationship between innovation and internationalization. As from the other aspect of the relationship between innovation and internationalization, innovation can trigger internationalization as well. Since innovative firms can seek for opportunities in across markets and may want to gain market share in those markets with their unique products or processes (Rogers, 2004 :144). Samsung is a good example for this statement. Samsung entered to new markets with its unique and cutting edge technological products and it widened the markets in which it operates. As it innovates, it wants to reach and satisfy new customers. Now, it holds a position which competes with the giants of the global markets.

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APPENDICES

Appendix 1: Questionnaire Form.

Sayın Katılımcı,

Bu çalışmanın amacı, Ege Bölgesinde Tekstil ve Hazır Giyim sektöründe faaliyet gösteren firmaların yurt dışı operasyonlarında uyguladıkları inovatif faaliyetlerin rolünü incelemektir.

Bu anketin işletmenizde alınan kararlarda rol oynayan kişilerce doldurulması araştırmamızın güvenilirliği açısından önem arz etmektedir. Bu çalışma sonucunda elde edilen bilgiler gizli tutulacak olup, çalışma sonuçları istek üzerine paylaşımaya açıktır.

Anketin cevaplandırılması 3-5 dakikanızı alacak olup, şimdiden çalışmaya sağladığınız değerli katkınız ve ayırdığınız zaman için çok teşekkür ederiz.

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BÖLÜM 1: Yenilik

Firmanızı göz önünde bulundurarak, firmanızın yurtdışı pazarlarda son 3 yılda gerçekleştirmiş olduğu yenilik faaliyetlerine ilişkin aşağıda yer alan ifadeleri değerlendiriniz.

UY1	Son 3 yılda firmamızca uygulamaya konulan ürün yenilikleri sayıda olmuştur.	SINIRLI						KAPSAMLI
		1	2	3	4	5	6	7
UY2	Ürün yenilikleri çoğunlukla olmuştur.	ADIM ADIM						KÖKLÜ
		1	2	3	4	5	6	7
SY1	Son 3 yılda firmamızca uygulamaya konulan süreç yenilikleri sayıda olmuştur.	SINIRLI						KAPSAMLI
		1	2	3	4	5	6	7
SY2	Süreç yenilikleri çoğunlukla olmuştur.	ADIM ADIM						KÖKLÜ
		1	2	3	4	5	6	7
YY1	Son 3 yılda firmamızca uygulamaya konulan yönetsel yenilikler sayıda olmuştur.	SINIRLI						KAPSAMLI
		1	2	3	4	5	6	7
YY2	Yönetsel yenilikler çoğunlukla ... olmuştur.	ADIM ADIM						KÖKLÜ
		1	2	3	4	5	6	7
PY1	Son 3 yılda firmamızca uygulamaya konulan pazarlama yenilikleri sayıda olmuştur.	SINIRLI						KAPSAMLI
		1	2	3	4	5	6	7
PY2	Pazarlama yenilikleri çoğunlukla ... olmuştur.	ADIM ADIM						KÖKLÜ
		1	2	3	4	5	6	7

BÖLÜM 2: Örgütsel Öğrenme		Kesinlikle Katılmıyorum						Kesinlikle Katılıyorum
Firmanızı göz önünde bulundurarak, aşağıdaki ifadeleri değerlendiriniz.								
EE1	Çalışanlar fuarlara ve sergilere düzenli olarak katılırlar.	1	2	3	4	5	6	7
EE2	Firmamızın uzun vadeli ve zengin kaynaklı araştırma ve geliştirme politikası vardır.	1	2	3	4	5	6	7
EE3	İşle ilgili yeni fikirler ve yaklaşımlar sürekli olarak denenmektedir.	1	2	3	4	5	6	7
ED1	Firmamızda farklı faaliyet alanları arasında bilgi paylaşımını sağlayacak etkili sistemler vardır.	1	2	3	4	5	6	7
ED2	Firma içinde, farklı çalışma grubu veya bölümlerde çalışan ve aynı zamanda bu çalışma grubu ve bölümler arasında bağlantı kuran kişiler vardır.	1	2	3	4	5	6	7
ED3	Çalışanların tavsiyelerini toplayan, birleştiren ve gerekli yerlere ulaştıran kişiler vardır.	1	2	3	4	5	6	7
BY1	Firmamızdaki tüm çalışanlar ortak bir amacı paylaşırlar.	1	2	3	4	5	6	7
BY2	Çalışanlar bilgi ve deneyimlerini birbirlerine aktarırlar.	1	2	3	4	5	6	7
BY3	Firmamızda grup çalışması çok yaygındır.	1	2	3	4	5	6	7
BS1	Firmada, konusuna göre dosyalanmış rehber ve e-postalar; konuyla ilgili uzmana her zaman ulaşılmasını sağlar.	1	2	3	4	5	6	7
BS2	Firmamızda müşteri veri tabanları güncel olarak tutulmaktadır.	1	2	3	4	5	6	7
BS3	Veri tabanları sürekli olarak güncel tutulurlar.	1	2	3	4	5	6	7
BS4	Çeşitli bilgisayar ağları (ağ yazılımları) (intranet, lotus notes) aracılığı ile firma veri tabanlarına ve belgelerine ulaşmak mümkündür.	1	2	3	4	5	6	7

BÖLÜM 3: Uluslararasılaşma		Kesinlikle Katılmıyorum						Kesinlikle Katılıyorum
Firmanızın uluslararası operasyonlarına ilişkin olarak aşağıda yer alan ifadeleri değerlendiriniz.								
UL1	İhracat yapmak firmamızın amaçladığı bir görevdir.	1	2	3	4	5	6	7
UL2	Firmamız ihracatını arttırmayı hedefliyor.	1	2	3	4	5	6	7
UL3	Uluslararası ticaret antlaşmaları firmamızın ihracat kararlarını etkilemiştir.	1	2	3	4	5	6	7

BÖLÜM 4: Firma Performansı	Çok Daha Kötü						Çok Daha İyi
Firmanızın bulunduğu pazarı göz önünde bulundurarak, firmanızın son 3 yıllık performansını aşağıda bahsi geçen ifadelerle göre pazardaki ana rakipleriyle karşılaştırınız.							
Pazar Payı	1	2	3	4	5	6	7
Müşteri Memnuniyeti	1	2	3	4	5	6	7
Rekabetçi Konumu	1	2	3	4	5	6	7
Müşteriyi Elde Tutma	1	2	3	4	5	6	7
Satış Büyümesi	1	2	3	4	5	6	7
Yatırım Getirisi	1	2	3	4	5	6	7
Genel Şirket Performansı	1	2	3	4	5	6	7

BÖLÜM 5: Girişimcilik		Kesinlikle Katılmıyorum						Kesinlikle Katılıyorum
Firmanızı göz önünde bulundurarak, aşağıdaki ifadelere katılım derecenizi belirtiniz.								
IEE1	Yöneticiler; araştırma-geliştirme, teknolojik liderlik ve yeniliklere önem verirler.	1	2	3	4	5	6	7
IEE2	Son 5 yılda, firmamız piyasaya geniş çaplı yeni ürün ve hizmet yelpazesi sunmuştur.	1	2	3	4	5	6	7
IEE3	Son 5 yılda, firmamız ürün ve hizmet yelpazesinde küçük çaplı değişiklikler yapmıştır.	1	2	3	4	5	6	7
SRE1	Firmamız, rakiplerimizin karşılık vermesini gerektiren faaliyetleri başlatarak rekabete yön verir.	1	2	3	4	5	6	7
SRE2	Firmamız rakiplerine üstünlük sağlamak için rekabetçi bir duruş sergiler.	1	2	3	4	5	6	7
RAE1	Genel olarak, yönetimin riskli projelere güçlü bir eğilimi vardır.	1	2	3	4	5	6	7
RAE2	Üst düzey yöneticiler, firmanın amaçlarına ulaşması için geniş kapsamlı cesur eylemlerin gerekli olduğuna inanırlar.	1	2	3	4	5	6	7
RAE3	Belirsizliğin yüksek olduğu durumlarda, firmamız 'bekle ve gör' duruşunu sergiler.	1	2	3	4	5	6	7
Y1	Yönetim, rakiplerin yeni süreçleri benimsemelerine aktif bir şekilde karşılık verir.	1	2	3	4	5	6	7
Y2	Firmamız, süreç yenilikleri yapmaya ve yepyeni çözümler bulmaya isteklidir.	1	2	3	4	5	6	7
Y3	Firmamız, çalışanlarını orijinal bir şekilde düşünceleri ve davranışları için cesaretlendirir.	1	2	3	4	5	6	7

BÖLÜM 6: Firmayla İlgili Genel Bilgiler

- Bulunduğunuz sektör
- Firmanızdaki toplam çalışan sayısı

Appendix 2: Questionnaire Form (Eng).

Dear Participant,

The aim of this study is to explore the role of innovation activities on the international operations of firms operating in the Aegean Region.

It is of importance that the questionnaire is answered by the qualified person who takes part in making vital decisions for the firm. The secrecy of the information gathered through this questionnaire is guaranteed.

To fill this questionnaire takes approximately 3-5 minutes. Thanks for your valuable contribution and time you spent.

Dokuz Eylul University - Res. Assist. Ayca Hizarci.

Part 1: Innovation								
Regarding your firm's last three-year operations, how do you evaluate the innovation activities undertaken?								
PI1	Product innovations introduced by our firm during the last 3 years have been.....	limited						extensive
		1	2	3	4	5	6	7
PI2	Product innovations introduced by our firm during the last 3 years have been.....	incremental						radical
		1	2	3	4	5	6	7
PRI1	Process innovations introduced by our firm during the last 3 years have been.....	limited						extensive
		1	2	3	4	5	6	7
PRI2	Process innovations have mainly been ...	incremental						radical
		1	2	3	4	5	6	7
MNI1	Managerial innovations introduced by our firm during the last 3 years have been ...	limited						extensive
		1	2	3	4	5	6	7
MNI2	Managerial innovations have mainly been	incremental						radical
		1	2	3	4	5	6	7
MR1	Marketing innovations introduced by our firm during the last 3 years have been	limited						extensive
		1	2	3	4	5	6	7
MR2	Marketing innovations have mainly been	incremental						radical
		1	2	3	4	5	6	7

Part 2: Organizational Learning		Strongly Disagree						Strongly Agree
Regarding your firm, please answer the questions below.								
Knowledge Acquisition								
KA1	The employees attend fairs and exhibitions regularly.	1	2	3	4	5	6	7
KA2	There is a consolidated and resourceful R&D policy.	1	2	3	4	5	6	7
KA3	New ideas and approaches on work performance are experimented continuously.	1	2	3	4	5	6	7
Knowledge Distribution								
KD1	The company has formal mechanisms to guarantee the sharing of the best practices among the different fields of the activity.	1	2	3	4	5	6	7
KD2	There are individuals within the organization who take part in several teams or divisions and who also act as links between them.	1	2	3	4	5	6	7
KD3	There are individuals responsible for collecting, assembling and distributing internally employees' suggestions.	1	2	3	4	5	6	7
Knowledge Interpretation								
KI1	All the members of the organization share the same aim to which they feel committed.	1	2	3	4	5	6	7
KI2	Employees share knowledge and experiences by talking to each other.	1	2	3	4	5	6	7
KI3	Teamwork is a very common practice in company.	1	2	3	4	5	6	7
Organizational Memory								
OM1	The company has directories or e-mails filed according to the field they belong to, so as to find an expert on a concrete issue at any time.	1	2	3	4	5	6	7
OM2	The company has up-to-date databases of its clients.	1	2	3	4	5	6	7
OM3	There is access to organization's databases and documents through some kind of network (Lotus Notes, intranet, etc.)	1	2	3	4	5	6	7
OM4	Databases are always kept up-to-date.	1	2	3	4	5	6	7

Part 3: Internationalization		Strongly Disagree						Strongly Agree
Regarding your firm, please answer the questions below.								
INT1	Exporting is a desirable task for our firm.	1	2	3	4	5	6	7
INT2	Our firm is planning to increase its export operations.	1	2	3	4	5	6	7
INT3	International trade agreements affect our export decisions.	1	2	3	4	5	6	7

Part 4: Firm Performance		Much Worse						Much Better
Regarding your firm's last three-year performance, how would you evaluate your firm's performance compared to the main competitors.								
BP1	Market Share	1	2	3	4	5	6	7
BP2	Customer Satisfaction	1	2	3	4	5	6	7
BP3	Competitive Position	1	2	3	4	5	6	7
BP4	Customer Retention	1	2	3	4	5	6	7
BP5	Sales Growth	1	2	3	4	5	6	7
BP6	Return on Investment	1	2	3	4	5	6	7
BP7	Overall Firm Performance	1	2	3	4	5	6	7

Part 5: Entrepreneurial Orientation		Strongly Disagree							Strongly Agree
Regarding your firm, please answer the questions below.									
Market Proactiveness									
MP1	Top managers favor a strong emphasis on R&D, technological leadership, and innovations.	1	2	3	4	5	6	7	
MP2	In the past 5 years, our organization has marketed a large variety of new lines of products and services.	1	2	3	4	5	6	7	
MP3	In the past 5 years, changes in our production or service lines have been mostly minor nature. (reverse coded)	1	2	3	4	5	6	7	
Competitive Aggressiveness									
CA1	In dealing with competitors, our organization often leads the competition initiating actions to which our competitors have to respond.	1	2	3	4	5	6	7	
CA2	Our organization typically adopts a very competitive posture aiming at overtaking the competitors.	1	2	3	4	5	6	7	
Risk Taking									
RT1	In general, the top managers of my organization have a strong propensity for high-risk projects.	1	2	3	4	5	6	7	
RT2	The top managers believe that bold, wide-ranging acts are necessary to achieve organization objectives.	1	2	3	4	5	6	7	
RT3	When there is uncertainty, our organization typically adopts a "wait and see posture". (reverse coded).	1	2	3	4	5	6	7	
Innovativeness									
INN1	Management actively responds to the adoption of 'new ways of doing things' by main competitors.	1	2	3	4	5	6	7	
INN2	We are willing to try new ways of doing things undertake and seek unusual, novel solutions.	1	2	3	4	5	6	7	
INN3	We encourage people to think and behave in original ways.	1	2	3	4	5	6	7	

Part 6: General Information about the Firm

- Sector in which the firm operates
- Number of employees