

# Chapter 5

## Untangling the Innovativeness– Performance Puzzle

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### ABSTRACT

*This chapter investigates the relationships between innovativeness and firm performance from a multidimensional viewpoint. As previous studies have shown controversial results on the performance implications for innovative capacity, the promising venue for the innovation research study is to address the question of under which conditions innovativeness leads to improved financial performance. To this end, the results of this study demonstrate some major findings. First, non-technical innovativeness exerts positive influence over technical innovativeness. Second, novelty of technical innovation activities causes a diminishing effect on financial performance due to the ambiguity of value-creation. Third, technical innovativeness enhances financial performance when the relationship between technical innovativeness and financial performance is mediated by market effectiveness and production efficiency. Overall, this chapter clarifies the conflicting results on the innovativeness-financial performance link and hence contributes to the innovation literature.*

### INTRODUCTION

Innovativeness is an evolving phenomenon of the new economy. Despite the central role of innovation for organizational growth in the knowledge economy, the performance implications of firm innovativeness still remain challenging. Innovative capacity of a firm would undoubtedly support the improvement of overall firm performance. However, empirical research on its performance implications shows controversial results. A large and considerable number of researchers investigating the technical innovativeness-performance relationship (e.g. Centobelli, Cerchione, & Singh, 2019; Cho & Pucik, 2005; Damanpour, Szabat, & Evan, 1989; DeCarolis & Deeds, 1999; Han, Kim, & Srivastava, 1998; Johne & Davies, 2000;

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Li & Atuahene-Gima, 2001; Marques & Ferreira, 2009; Pett & Wolff, 2009; Roberts, 1999; Vermeulen, De Jong, & O'Shaughnessy, 2005; Xin, Yeung, & Cheng, 2010) support the positive performance implications. The others (e.g. Freel & Robson, 2004; Heunks, 1998; Moreira, Gherman, & Sousa, 2017) report either negative or statistically insignificant effect of technical innovativeness on performance. These conflicting research results deal exclusively with the unidimensional nature of performance measurement (Rosenbusch, Brinckmann, & Bausch, 2011; Subramanian & Nilakanta, 1996). The financial measures such as return on assets or profitability cannot fully account for all aspects of firm performance. Innovativeness requires extra investments and significant expenditures made in existing production systems, but at the same time potential future returns from the innovations cannot be known precisely since the success of innovation projects depends on the impact of novelties on the areas relevant for production and markets (Mackelprang, Bernardes, Burke, & Welter, 2018; Talay, Akdeniz, & Kirca, 2017).

Starting from this gap, the study here aims at investigating the relationships between innovativeness and firm performance from a multidimensional viewpoint and hence answering the question of under which conditions innovativeness leads to improved financial performance. Unlike the previous studies examining direct positive or negative performance implications of innovation practice, this study considers indirect influences of innovativeness as well. For-profit organizations distinguish successful new products from unsuccessful ones due to the financial performance. This performance measure produces a misleading correlation between innovativeness and profitability in the short-run period. During the early-phase of launching innovation, high capital expenditures for innovations may inevitably cause a negative influence on profitability ratio. The research findings provide evidence for consumer resistance to adopt the innovations in the introduction stage of product life cycle (Ram & Jung, 1991). Then, in correlation with consumer attitude and satisfaction, adoption and repetitive usage of a new product eliminates the negative influence of innovation resistance on profitability. In other words, positive financial outcomes from innovation activities, especially with a great amount of investments in R&D, most likely appear at a saturation point above which an increase in R&D intensity leads to negative returns (Molina-Morales & Expósito-Langa, 2012). Accordingly, this study advocates that firm-level innovativeness creates a positive aggregate impact on financial performance that results from the mediating effects of innovation process outcomes. Innovation process outcomes basically consist of measures for market effectiveness and production efficiency (OECD & Eurostat, 2018). Financial performance would be higher when the bottom line-profitability effect of firm innovativeness is mediated by market effectiveness with potential for value-creation from a revenue generation focus and production efficiency with potential for value-creation from a cost reduction focus (Subramanian & Nilakanta, 1996).

Based on the aforementioned arguments, we expect that firm innovativeness positively affects financial performance, yet that this effect depends on the value-increasing potential of innovation novelty. This study uses quantitative data for SMEs in manufacturing industry. SMEs have a limited availability of resources. The resource scarcity diminishes the organizational capacity to absorb innovation failure and risks. That is why research in such a specific context is more likely to produce more realistic conclusion on performance implications of firm innovativeness. Furthermore, the traditional output (e.g. number of new products and patents, share of sales derived from new products) and input indicators (e.g. R&D intensity, R&D employees, number of R&D alliances) are questionable for assessing the influence of innovativeness skills on the growth of SMEs. For this reason, we adopt the new paradigmatic approach to innovation measurement and evaluate firm innovativeness with a broader systemic nature of innovation including reciprocal relationship between technical and non-technical facets of innovations. The results of this study indicate that technical innovativeness leads to the changes in both “production and delivery”

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