

Open Innovation as Means of Building Social Capital: A Way to Globalization for Traditional SMEs

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This research explores innovation of traditional SMEs that do not actively invest in innovation. Elements of open innovation have been identified in these firms in their effort to build social capital which they perceive as pertinent to their businesses. The result of the research shows that instead of using social capital as means for innovation, the unintentional practice of open innovation has contributed to the development of social capital, which further opens up potential for globalization. As a result, a model of open innovation as means of developing social capital for enhancing globalization potential for SMEs was developed.

INTRODUCTION

In the highly competitive global market, ability of small-to-medium enterprises (SMEs) to innovate new products is seen to be of strong influence to the nation's economic development (Xie, Zheng, and Tam, 2010). At the organizational level, more than the creation of new products, other forms of innovation as identified by Schumpeter (1934), including new ways of production; opening up new market; sourcing new supplies or developing a new organization of industry, are pertinent to the growth and survival of enterprises (Schumpeter, 1934). Therefore, innovation in any form within the organization is an important element in the successful performance of enterprises and the major contribution to competitive advantages (Anderson, Potocnik and Zhou, 2014). While innovation is highly valued by entrepreneurial enterprises, and the pressure from competition and globalization has made innovation impetus to their survival (Birchall, Chanaron and Soderquist, 1996), the case studies in this paper show that there are long sustaining traditional SMEs in Macao that are not proactively seeking to innovate, nor see the need for innovation. Although these SMEs admit that innovation is important to compete in the modern business world, they do not perceive as much importance in innovation as they do building social capital.

However, this research discovers that these traditional SMEs have been practicing open innovation unintentionally, achieving product innovation in the form of product refinement, and process innovation over the years, and have thus enhanced their social capital, in the form of trust, extended network and social reputation, which they perceived as their competitive advantage.

Extensive research has been conducted in studying the internationalization of SMEs (Ruzzier, Hisrich & Antoncic, 2006). There has also been a number of research on the mediating role of social capital or social networks between open innovation and firm performance, emphasizing on the importance of social capital for small-to-medium enterprises (SMEs) in their implementation of open innovation (Rass,

Dumbach, Danzinger, Bullinger & Moeslein, 2013; Lee, Park, Yoon & Park, 2010). However, the effect of open innovation on building social capital, and the relationships between open innovation, social capital and globalization of SMEs have yet to be studied. This exploratory research is a first attempt to fill this research gap. Through multiple-case studies of five traditional SMEs in Macao, this research addresses three questions: How does innovation take place in traditional SMEs that do not actively invest in innovation? How does innovation affect social capital development in these SMEs? And to what extent does innovation contribute to globalization of SMEs? By answering these questions, this paper presents a model of open innovation as means of developing social capital for enhancing globalization potential of SMEs.

The following parts explore the concept of open innovation, social capital, and globalization of SMEs.

LITERATURE REVIEW

Open Innovation

Since the introduction of open innovation as a new paradigm for innovation studies by Chesbrough (2003), the concept has been widely used with Henry Chesbrough's 2003 book gathering from more than 1,800 citations in 2010 (Huizingh, 2011) to more than 12,000 citations in 2017 (Google Scholar, July 2017). As the term indicates, the idea of open innovation relates to the attempt of organisations to open up and extend their innovation process outside of the organizations (Huizingh, 2011), and defined as 'the use of purposive inflows and outflows of knowledge to accelerate internal innovation, and to expand the markets for external use of innovation' (Chesbrough, Vanhaverbeke, and West, 2006, p.1), open innovation is obviously practiced by organisations with strong intention to innovate.

Although research in open innovation has traditionally been studied in large innovative firms SMEs are seen to have less access to and fewer technological assets to exchange with external sources (Lee et. al., 2010), there are evidence that open innovation is present in SMEs and is being increasingly adopted as they are motivated by market-related targets (Vrande, Jong, Vanhaverbeke, & Rochemont, 2009). While the need for SMEs to drive innovation comes from the enhanced competition in the fast-changing and globalizing market (Xu, Lin and Lin, 2008; Xie, et. al. 2010), the process of innovation used by Chinese SMEs is seen to be capitalizing on the competitive advantage of their already existing business networks (Xu et. al., 2008) which further proves that open innovation is present and already been practiced by SMEs in their innovation attempts. However, not all SMEs are actively investing in innovation, and yet, open innovation can still be present.

One phenomenon among traditional SMEs in Macao is that they do not invest in any product innovation or process innovation on purpose. Rather, through their attempt in network and relationship building with customers and the community for the purpose of enhancing social capital, they have been practicing customer involvement, external networking and participation, outsourcing R&D, and acquiring external knowledge, which are identified as practice of technology exploration of open innovation (Vrande et. al., 2009) resulting in products or process innovation. So, instead of using their social capital and networking as a mediator in enhancing innovation in SMEs, as shown in earlier research on Chinese SMEs' innovation (see Lee et. al., 2010; Rass et. al., 2013; Xie et. al., 2010; and Xu et. al., 2008), in the case of traditional businesses in Macao, open innovation has unintentionally been used as a means to develop social capital.

In this paper, evidences of open innovation in SMEs are adapted from the activities of technology exploitation and technology exploration identified by Vrande et. al. (2009) including "venturing, outward licensing of intellectual property (IP), involvement of non-R&D workers in innovation initiatives [...] customer involvement, external networking, external participation, outsourcing R&D, and inward licensing of IP" (p.424-425).

Social Capital

In their effort to review and integrate the concept of social capital developed across different fields, Adler & Kwon (2002) categorised two different forms of social capital according to the definitions of different scholars, as “bridging” and “bonding”. The bridging and bonding social capital were first introduced by Putnam (2000), referring to networks across class and groups, as opposed to the bonding social capital referring to horizontal networks within the same class. Adler & Kwon (2002) further generalized these two categories of social capital. The first form of social capital - “bridging”, focuses on external relations developed from works of early scholars of social capital theory, including Bourdieu’s (1985) resources linking to durable networks of relationships, and Granovetter’s (1973) weak ties, as well as, Burt’s (1992) bridging of structural holes which allowed privileged access to information and knowledge. By enhancing this form of external, or bridging capital, traditional SMEs in Macao often share their own networks, knowledge and know-how. There is also high level of customers’ involvement in their attempt to create more personalized network with customers.

The second form of social capital, “bonding”, focuses on strengthening internal ties through creating a tight social structure within a group with shared actions within the structure (Coleman, 1990), creating a common purpose for the group to work tightly together (Fukyama, 1995), and establishing strong internal networks, norms and social trust which motivates coordination leading to cooperation between individuals for mutual benefits (Putnam, 1995). In order to build up a tight internal network or bonding social capital, traditional SMEs tend to be open in their sharing of information among staff from different departments, and involve staff from different departments to come up with new ideas to solve problems or improve services.

According to Nahapiet and Ghoshal (1998), “differences between firms, including differences in their performance, may represent differences in their ability to create and exploit social capital” (p.260). This is especially true for Chinese SMEs whose key competitive advantage is considered to be their ability to exploit networks and external relations (Mathews and Zander, 2007). And the social capital embedded within Chinese SMEs has shown to be more important in their effort to internationalize than innovativeness (Zhang, Ma and Wang, 2012), and hence, being a key element for the globalisation strategy of SMEs, as they tend to develop international markets through existing network.

Globalization of SMEs

Globalization refers to the operation of a business being geographically dispersed is seen as an extension of internationalization (Ruzzier, Hisrich & Antoncic, 2006) which can be defined as the “process of developing networks of business relationships in other countries” (Johanson & Mattsson, 1993, p.306). In other words, internationalization is the first step of globalization. Both internationalization and globalization of SMEs have developed from being a trend at the end of the last century to being a fact now where there are hardly any businesses not affected by globalization. As technology, communication and transportation continue to develop, businesses can easily access or provide resources and information from different parts of the world, causing boundaries between local and international markets to be less relevant (Knight, 2000).

However, SMEs in both transitional and developed economy tend to face challenges in logistics arrangements, and those in transitional economy, such as that in Macao and China, also face the challenge of product quality acceptance (Neupert, Baughn & Dao, 2006). Therefore, whether for inward and outward internationalization of SMEs, information and referrals are important, and this could be gained through social networks which can provide knowledge and advice of foreign markets and/or resources, as well as referral trust and solidarity (Zhou, Wu & Luo, 2007).

This research does not attempt to analyze the globalization strategies of SMEs in Macao. Instead, the result of this paper shows evidence that enhancing the social capital of SMEs creates advantages for them to enter the global market, and the practice of open innovation has profound effect on developing the social capital for SMEs, especially for SMEs that perceived themselves as traditional rather than innovation as they are not active in investing in innovation.

METHODOLOGY

This exploratory research adopts a multiple-case studies method which allows more in-depth understanding (Morse and Field, 1995) and provision of insights into a phenomenon which answers the ‘how’ questions (Yin, 2009). This research looks into five traditional SMEs from different low-tech fields in Macao. The reason for selecting traditional SMEs is that this research attempts to prove that open innovation exists even in firms that do not actively innovate. Therefore, selected subjects are SMEs running for over 10 years and perceived themselves as traditional rather than innovative, thus representing the phenomenon (Eisenhardt, 1989) to study the questions: How does innovation take place in SMEs that do not actively invest in innovation? How does innovation affect social capital development in these SMEs? And to what extent does innovation contribute to globalization of SMEs? Table 1 presents some background information for the five cases.

TABLE 1
BACKGROUND INFORMATION

	Case A	Case B	Case C	Case D	Case E
Business Activity	Auditing Firm	Trading Company	Traditional style Café	Beauty Centre	Events Company
Ownership Type	Private Family Owned	Private Family Owned	Private Family Owned	Private Partnership	Private Partnership
Founding Year	1979	1975	1965	1995	2006
Approx. No. of employees	30	50	25	10	4
No. of owners & managers interviewed	2	2	3	2	1
Indication of Business Globalization	Providing service to international clients of off-shore companies	Multiple distributor from different countries; re-exporting to Mainland China	Suppliers from outside of Macao	Suppliers of products and equipment from outside of Macao	Organising events outside of Macao for local clients; and for international clients in Macao

A multi-methods approach was used to capture and triangulate data to ensure reliability and validity (Yin, 2009). Main source of data included in-depth semi-structured interviews and observations. Primary data was complemented with secondary sources including online media, news articles, and informal interviews with stakeholders of the SMEs. The data was collected over a period of 18 months. All interviews were conducted in Cantonese, and the original language of the interviews were used for analysis. Qualitative content analysis is used to analyze the data from the in-depth interviews as the data are obtained from narrative responses to open-ended questions, and the analysis was conducted in order to identify process and phenomenon which ‘goes beyond merely counting words’ (Hsieh & Shannon, 2005, p.1278). So, analysis was conducted to identify activities of open innovation being practiced by the SMEs, the innovative outcome and their relations to social capital development. Data from the core interviews are then cross-checked for support from secondary data, observation notes, and informal interviews.

RESULTS

This case study research focus on traditional SMEs which are all low-tech firms not proactively investing in new products development, so some of the activities of open innovation identified by Vrande et. al. (2009) such as outsourcing R&D and inward licensing of IP are not applicable as there is no evidence of these five SMEs investing in third party to create new products. Although not having R&D department, there are high levels of involvement of staff from different departments for generating ideas for service refinement. According to both the incumbent and the successor in Case A in separate interviews, both mentioned that the new sector of their business was created after many informal discussions among family and non-family members of their staff. In Case B, the marketing manager explains that *“whenever we find a new product [food or beverage], I invite managers from different departments, even colleagues from office supplies, to taste the product together. Then we brainstorm what the product can be used for”* as of whether to sell directly in their own shops or use for creating new dishes in one of their restaurants. The experiencing of new products/services with different member of staff is observed in Case C and D. In Case C, new dishes in the café and new service processes are created as an effort of information sharing between kitchen staff and front-line staff which are being discussed informally during lunch together every day. The two business owners in Case D, both explained that *“when we see any new treatment in the market, we have our staff all learn and take turns giving facials and massages to each other. From this, we all discuss how to make our service better than others”*. These activities, although mostly for service improvement from the point of the view of the traditional SME owners, fit the criteria for involvement of non-R&D workers in innovative initiatives as explained in Vrande et al.’s (2009) paper.

Also, though these low-tech SMEs do not own official intellectual property that can be licensed to a third party, this indicator of open innovation is adapted to sharing knowledge and network to a third party for potential of new initiatives. This is especially strong with Case 2, the trading firm with strong connection with Mainland China, which is an important market for SMEs in Macao. In order to enhance their connection and influence in the local market, they constantly organize trade fair and trade visits introducing local SMEs to government officials and large organizations in the Mainland. They have also introduced international suppliers to competitors in their industry. According to the owner of the firm *“our main target is to help local SMEs achieve higher product and service quality, and for this, we need to open our eyes and explore outside of Macao”*. So, in order to expand their own connection, they have been sharing their networks and know-how in exploring international markets. This outward sharing of knowledge and network which is an act of open innovation, although not for the sake of innovation but for developing social capital, has contributed to development of new businesses and partnerships, and enhancing global connections.

There are also strong indication of customer involvement and external networking in all five SMEs being studied. While the motivation for customer involvement has been to develop stronger ties with customers, this involvement shows unexpected result of process, product or service innovation. For instances, the specialty of Case C, a simple egg sandwich, but with an almost 3-inch thick omelet in the middle, was once considered an innovation, and still is among tourists, was a result of involving customers in thinking how their product could be made different. The act was to better serve customers, but the outcome was an innovative product. In Case E, the owner emphasized that *“we do things the traditional way because customers do not like new things. They come to us because they saw an event we organised and wanted one just the same.”* However, it has been observed that innovation happens in many steps throughout their process. While discussing about events with different clients, the company kept coming out with new ideas, on how to achieve the outcome. This fits the definition of process innovation, of using new ways to do the same thing (Schumpeter, 1934).

As for external networking, Case D showed high interest in connecting with different suppliers and often visit trade fairs of new machines or facial products in Hong Kong. The owners expressed that *“we need to meet more suppliers and people in the industry so we can find better offers, and to establish better network so we can keep updated of new products”*. But it is observed that, this networking resulted in

creation of new services unique to this small firm. By external networking, the owners learnt about new technology, and through involving all their staff in sharing and exploring they have consistently been introducing new treatments using combination of different products. Also, they have been able to source from suppliers from different European countries in the last few years. Thus, through external networking, they achieve enhanced social network, service innovation, and further globalization. Even the least innovative traditional SMEs, as they self-perceived, in Case C, is active in external networking in building good relationships within their own community. The successors of the business are also actively participating in local associations to enhance his network, and these initiatives to build social capital have resulted in product/service innovation as one of the member of staff puts it “*we know everyone in the neighborhood, sometimes they tell us what is wrong with our café (in service or product), so we think of ways to improve, and they are happy with us and trust us.*”

Activities such as venturing, customer involvement, external networking, and external participation, which are all activities of open innovation are identified in the different cases in this study, although not all elements of open innovation are present in every case. For these traditional businesses, they perceived their actions are taken for developing social capital which they consider important for their business development, or in some cases, merely for survival. A summary of SMEs’ social capital development and open innovation activities is shown in Table 2.

TABLE 2
OVERVIEW OF SMES’ SOCIAL CAPITAL DEVELOPMENT AND OPEN INNOVATION ACTIVITIES

Open Innovation related Activities	Actions in Developing SMEs’ Social Capital				
	Case A Auditing Firm	Case B Trading Firm	Case C Traditional style Café	Case D Beauty Center	Case E Events Company
Venturing	Established new business sector providing secretarial service for clients	Opened own supermarkets to sell directly to end users	-----	-----	Joint ventures with different firms to initiate new events in Macao
Outward sharing of knowledge and network	-----	Sharing networks and connection in Mainland China to help local SMEs expand	-----	-----	Sharing personal networks with potential partners to explore new initiatives

			Actions in Developing SMEs' Social Capital		
Open Innovation related Activities	Case A Auditing Firm	Case B Trading Firm	Case C Traditional style Café	Case D Beauty Center	Case E Events Company
Involvement of non-R&D workers	Brainstorming with all staff to create new service for clients	Products testing with managers from different departments to identify new markets and new use of products	Sitting down with staff and family members in creating new menus and identifying new process for more efficient service	Encourage staff to try services in other centers to create new service and processes together	Involve partners and staff to create of new ways of organizing events
Customer involvement	New and refined service created based on customers' suggestion	Taking clients suggestions in selecting new distributors and brands; and improving service process	Constantly improving taste of food serve from daily communication with customers	Creating new service based on suggestions from regular customers	Work closely with clients to design new ways of doing things
External networking	Managers and staff encouraged to attend community events; business successor encouraged to join industry associations	Participation in different associations and networking events; organizing collaborated events among local SMEs to explore Mainland China's market; sharing of networks of international distributors to other local SMEs	Maintain close relationship with suppliers, customers and neighbors in the community	Maintain close relationship with suppliers, often visit potential new suppliers for machines in Hong Kong and other nearby countries	Active participation in events in Macao and Mainland China, networking with different organizations and collaborate with different parties

			Actions in Developing SMEs' Social Capital		
Open Innovation related Activities	Case A Auditing Firm	Case B Trading Firm	Case C Traditional style Café	Case D Beauty Center	Case E Events Company
External participation	-----	Investments in other businesses in the F&B industry expanding own supply chain and provide better understanding of products needed to be imported	-----	-----	Investment in unrelated trading business which expands network and forms of events to organize

DISCUSSION

The result of this research shows that although traditional SMEs in Macao, such as those selected for this study, that do not perceive themselves as innovative and do not invest in innovation as a strategy for achieving competitive advantages are practicing open innovation in their attempt to widen business network and building social capital. All the cases showed activities in the area of involvement of non-R&D workers in innovative initiatives, customer involvement and external networking. This finding may not be surprising because these activities are relevant to the development of social capital in strengthening internal bonds and tightening relationships. However, through these actions, the companies were able to come up with new products and services, and new process of doing things, which are what innovative companies are actively investing in. Moreover, through participation in external networks, these SMEs, even without intention to globalize, have in one way or another brought their businesses outside of Macao, whether in sourcing international suppliers or selling local services to international businesses.

Some of these cases are also investing in new ventures as a way to expand customer base and network and to develop relationships with new partners in order to expand their businesses. These initiatives ended up not only contributing to stronger social capital for the SMEs, but also stimulating ideas for new products and opening up markets. Therefore, if traditional SMEs in Macao actively invest in open innovation, they can benefit from both enhanced social network and creation of innovative products or business ideas doubling their competitive advantages. These social networks have also contributed to local SMEs in sourcing for suppliers in the international market, and to attract customers from outside of Macao, even though these are localized small businesses in the city.

In their attempt to enhance social network, Chinese SMEs set up ventures to better serve customers or build collaboration with business partners; share network and connection with the industry; involve staff and customers in service, products and process improvements; participate in external networking; and invest in businesses of stakeholders. These efforts coincide with activities of open innovation proposed by Vrande et al. (2009). As a result, innovation within these SMEs took place in the form of new and refined products and service delivery process; sourcing of new supplies that lead to new ways of doing things; and opening up new markets through networking or venturing into new business domain through open innovation activities which successfully enhance their social capital. The involvement of customers and non-R&D staff in service refinement led to higher trust and solidarity among customers, and stronger

internal bonds among staff as they all work together for a common purpose (Fukyama, 1995), to make their products and service better for customers, or find more efficient process for delivery of services.

The enhanced social capital resulting from the SMEs' unintended innovation showed contribution to getting traditional SMEs started in globalization. Firstly, through their external network, they were introduced to or made aware of international suppliers for new resources. Secondly, they could also be introduced to the international market gaining international customers whether their services are provided in or outside of Macao. Also, through new networks formed with international partners, traditional SMEs get further exposures and opportunity for international marketing.

As a result of this empirical research, the following three propositions were developed in answer to the three research questions this paper sets out to answer, explaining how open innovation can contribute to social capital development in SMEs, which in turn contribute to the globalization of local traditional SMEs, thus enhancing their competitive advantages in facing competition from more and more international businesses entering Macao. The following three propositions can contribute to further studies in a larger scale.

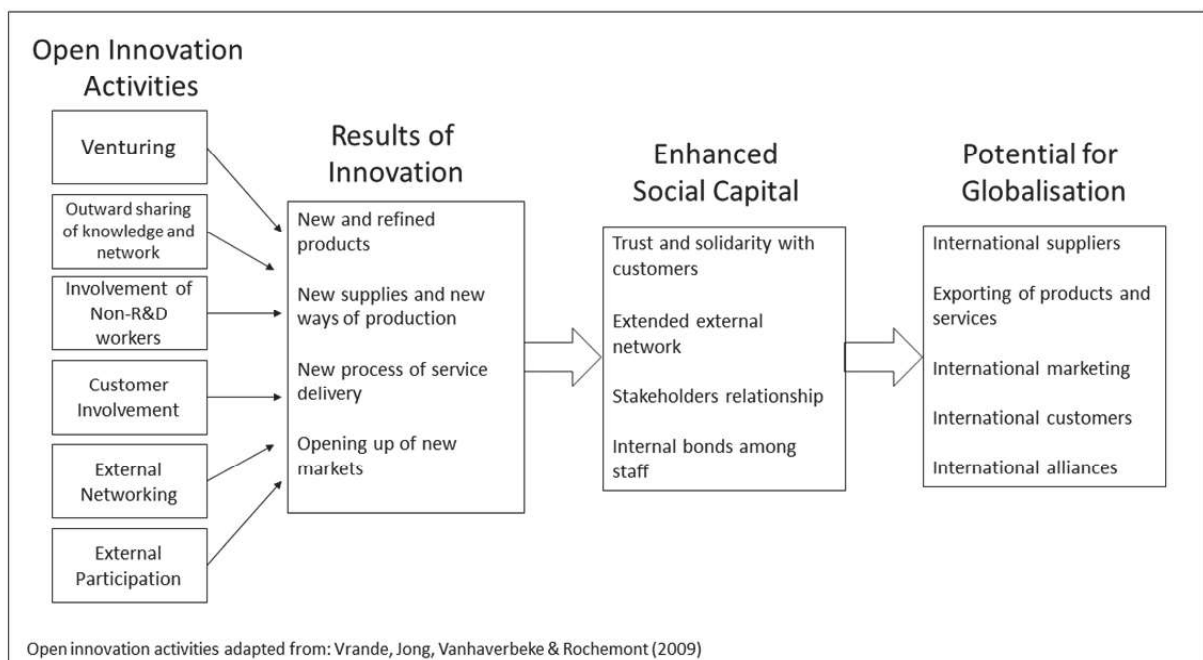
SMEs' actions for building social capital including venturing, outward sharing of knowledge, involvement of non-R&D staff, customer involvement and external networking lead to innovation in the form of product/service, process and market innovation.

Result of innovation in SMEs including refined products, new ways of production, new process of service delivery and new markets enhanced social capital for the SMEs in the forms of trust and solidarity with customers, extended external network, tighter stakeholders' relationships and enhanced internal bonding with staff.

Enhanced trust and solidarity with customers, external network and stakeholders' relationship create potential for SMEs' globalisation in terms of sourcing international suppliers, exporting of products and services, international marketing, attracting international customers and alliances.

From the propositions, a model (see Figure 1) is developed to explain the result of the research.

FIGURE 1
MODEL OF OPEN INNOVATION AS MEANS OF DEVELOPING SOCIAL CAPITAL
FOR ENHANCING GLOBALIZATION POTENTIAL FOR SMES



This empirical research as a first attempt in studying the effect of open innovation on social capital as a strategy for globalization is not without its limitation. Firstly, the sample focus on traditional SMEs may not be enough to generalize for younger and more innovative SMEs. Although the intention of this research was to study traditional SMEs, adaptation will be needed to extend the study to other more innovative SMEs. Secondly, the indicators of open innovation are quite general and further research focusing on open innovation activities may be required for more specific definition in order to further pinpoint the indicators of open innovation practice. Finally, the success of globalization of these cases is not measured as these firms are still in the first steps of globalization, for most it was unintentional as a result of their development of social capital.

Therefore, further research is suggested to study open innovation practice of a wider and more diverse sample of SMEs for better generalization and identification of more detailed definition of open innovation indicators starting from developing qualitative measures based on the propositions from this research. Moreover, the outcome of globalization as a result of social capital built from open innovation can be further studied by analyzing SMEs that have gain growth or financial success through their globalization endeavors.

CONCLUSION

Research in the area of open innovation has skyrocketed since the introduction of the concept. Although earlier research focus on large innovative firms, the attention has been brought to SMEs' open innovation practice in the last few years. Despite the fact that there are existing researches in the area of innovation and social capital, not many of them focus on open innovation. Moreover, past researches look at social capital as a mediator of innovation rather than vice-versa. Therefore, this paper fills in the research gap contributing to the theoretical development of open innovation and social capital. Furthermore, this research extends its contribution from the studies of open innovation and social capital to globalization of SMEs, creating a new model for further exploration of open innovation as a means of building social capital for globalization of Chinese SMEs.

Traditional SMEs in a transitive economy like Macao may not actively seek for growth and expansion. Therefore, although they understand the importance of innovation in the fast-changing, more internationalized economy, they do not perceive the need for innovation. In fact, interviewees in these cases are under the perception that their customers will not be open to new products they provide. However, innovation can benefit them in other ways. At the practical level, this research shows that if SMEs in Macao actively invest in open innovation, they can benefit from both enhanced social network and creation of innovative products or processes. And in turn, these innovations further develop their social capital. Finally, this social capital contributes to SMEs in sourcing for global suppliers and reaching customers outside of Macao, allowing them to enjoy the benefit of globalization.

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