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Linkages between Innovation Policies and SMEs' Innovation Activities: Empirical Evidence from 15 Transition Countries

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Abstract : Innovation is one of the key foundations of competitive advantage, generating growth and welfare worldwide. Consequently, all firms should innovate to bring new ideas to the market. Innovation is a vital growth driver, particularly for transition countries to move towards knowledge-based, high-income economies. However, numerous barriers, such as financial, regulatory or infrastructural constraints prevent, in particular, new and small firms in transition countries from innovating. Thus SMEs' innovation output may benefit substantially from government support. This research paper aims to assess the effect of government interventions on innovation activities in SMEs in emerging countries. Until now academic research related to the innovation policies focused either on single country and/or high-income countries assessments and less on cross-country and/or low and middle-income countries. Therefore the paper seeks to close the research gap by providing empirical evidence from 8,500 firms in 15 transition countries (Eastern Europe, South Caucasus, South East Europe, Middle East and North Africa). Using firm-level data from the Business Environment and Enterprise Performance Survey of the World Bank and EBRD and policy data from the SME Policy Index of the OECD, the paper investigates how government interventions affect SME's likelihood of investing in any technological and non-technological innovation. Using the Standard Linear Regression, the impact of government interventions on SMEs' innovation output and R&D activities is measured. The empirical analysis suggests that a firm's decision to invest into innovative activities is sensitive to government interventions. A firm's likelihood to invest into innovative activities increases by 3% to 8%, if the innovation eco-system noticeably improves (measured by an increase of 1 level in the SME Policy Index). At the same time, a better eco-system encourages SMEs to invest more in R&D. Government reforms in establishing a dedicated policy framework (IP legislation), institutional infrastructure (science and technology parks, incubators) and financial support (public R&D grants, innovation vouchers) are particularly relevant to stimulate innovation performance in SMEs. Particular segments of the SME population, namely micro and manufacturing firms, are more likely to benefit from an increased innovation framework conditions. The marginal effects are particularly strong on product innovation, process innovation, and marketing innovation, but less on management innovation. In conclusion, government interventions supporting innovation will likely lead to higher innovation performance of SMEs. They increase productivity at both firm and country level, which is a vital step in transitioning towards knowledge-based market economies.

Keywords : innovation, research and development, government interventions, economic development, small and medium-sized enterprises, transition countries
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