ANALYZING THE INTERNATIONALIZATION OF SMALL AND MEDIUM ENTERPRISES (SMEs)

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ABSTRACT

This article investigates the processes and influential factors affecting the internationalization of small and medium-sized enterprises (SMEs). Internationalization of SMEs has been widely researched but little is known of how and why internationalization takes place in developing country. The aim of this paper is to study the internationalization theories, such as the incremental and rapid internationalization models, networking, resources-based and international entrepreneurship perspectives. The article is based on an in-depth qualitative study of data collected from books, articles, web and e-books. The analysis is a descriptive process, through literature study that collecting information, summarizing the research, classifying the data and then describing the variables. The conclusion of this study is centered on key personnel and firm competencies as the main drivers of internationalization. The entrepreneurs' knowledge (experience), behavior and cognition are identified as an attribute of the firm that influences internationalization decisions. In addition, the successful engagement in international markets depends on the ability of management in a firm to recognize, set the appropriate strategies and exploit opportunities by consider the internal and external factors. More importantly, the study suggests that networking relationship create internationalization awareness and provide appropriate pathways to internationalization.

Keywords: *internationalization, small and medium enterprises*

INTRODUCTION

In the current global economic, small and medium-sized enterprise has become essential towards economic growth of a country. Various regulations are designed to encourage the birth of SMEs and entrepreneurial passion in the society. Furthermore, the changing business environment creates new opportunities for SMEs to internationalize. Some studies have found links between internationally oriented entrepreneurship and economic growth. Hessels and Van Stel (2006) find that export oriented entrepreneurship contributes more strongly to macro-economic growth than entrepreneurial activity in general, both for highly developed countries and transition countries. The role SMEs play in helping countries become global players has been of central interest among leaders in the Asia-Pacific Economic Cooperation (APEC) and the Association of Southeast Asian Nations (ASEAN). The APEC leaders agree that SMEs play critical roles in enhancing investment, generating jobs and managing sustainable development (APEC, 1996).

The internationalization of Small and Medium enterprises (SMEs) is the outcome of dynamic process that may be initially motivated by saturated and limited domestic markets, or by enquiries from overseas (Deakins et al., 2013). This internationalization can take many forms, such as import, export and foreign direct investment (FDI). Reynolds (1997) argues that generally SMEs tends to move into foreign markets as exporters and/or foreign investors.Smaller firms traditionally focused on their domestic market, and majority of SMEs will most likely continue to do so in the future. Smaller firms find it hard to overcome the foreign challenges, and often suffer from their limited size and resources. Meanwhile, for large firms often build a co-operation with another large firm to overcome the availability of resources and any other needs.

The internationalization has been viewed from several perspectives. It has been described by the stage of development models, networked based approaches and resource-based strategies.Another perspective is the rapid internationalization model, which posits that many firms internationalize in a rapid manner, and sometimes from inception. These firms are called, among others, Born Global (McKinsey & Co., 1993) and International New Ventures (McDougall, et al 1994). In contrast, another perspective is the incremental internationalization model, which posits that firms gradually internationalize in an incremental manner through a series of evolutionary 'stages' (Chetty and Stangl, 2010). Next, the factors influencing SMEs internationalization such as entrepreneur characteristics, firm characteristics and environmental characteristics were also discussed.

Research Objectives

The objectives of this research are to analyze the key factors influencing SMEs internationalization and the internationalization process of SMEs.

THEORETICAL REVIEW

Small and Medium-sized Enterprises

In the European Union SMEs are defined in the Commission Recommendation of May 6, 2003. Concerning to this recommendation an enterprise is regarded as small or medium sized if it has:
1) not more than 250 employees and
2) not more than 50 million euro turnover response a balance sheet total of less than 43 million euro and
3) if not more than 25% of the shares of such an enterprise are in the ownership of another enterprise.

The definitions are given bellow:

Table 1. European Union's categorize of SMEs.

Enterprise category	Staff Headcount	Turnover	Balance sheet Total
Medium	< 250	≤ € 50 million	≤ € 43 million
Small	< 50	≤ € 10 million	≤ € 10 million
Micro	< 10	≤ € 2 million	≤ € 2 million

Source: European Commission, 2003**.**

In Indonesia, the Ministry of Cooperatives and Small and Medium Enterprises as regulated in Act. No. 20, Year 2008 regarding the Micro, Small and Medium Enterprises (SMEs) are categorized (in rupiah) as follow:

Table 2. Indonesia's categorize of SMEs.

No	Category	Criteria	
		Assets (Rp)	Turnover (Rp)
1	Micro	Max 50 million	Max 300 million
2	Small	> 50 – 500 million	> 300 million – 2,5 billion
3	Medium	> 500 – 10 billion	> 2,5 million – 50 billion

Source: The Ministry of Cooperatives and Small and Medium Enterprises, Republic of Indonesia

Internationalization

The internationalization of SMEs is the outcome of dynamic process that may be initially motivated by saturated and limited domestic markets, or by enquiries from overseas (Deakins et al., 2013). Saturated and limited domestic markets happened when companies offered the same product as many others did, so that product or service is becoming commoditized. Senik (2010) said that internationalization is the process through which a firm moves from operating in its domestic market place to international markets by adopting the firms' operations such as strategy, structure and resources, to the international environment. Although domestic markets may be important as a launching platform for new market offerings, firms that operate in this sector often need to commercialize on a global scale (Vasilchenko and Morish, 2011).

Approaches to SMEs Internationalization

This study review two different approaches a company can take when entering international markets. In the internationalization process this model reviewed in each firm whether it was radical or incremental. Chetty and Stangl (2010) categorized the relationship of internationalization process and type of innovation in each firm whether it was radical or incremental. In summary they propose: 1) firms with a radical innovation and diverse network relationships are more likely to have radical internationalization; 2) firms with an incremental innovation and financial relationships are more likely to have radical internationalization; 3) firms with a radical innovation in a rapidly changing technological environment and that lack financial relationships are more likely to internationalize incrementally; and 4) firms with an incremental innovation that are small, young and have few network relationships are more likely to internationalize incrementally.

The radical internationalization is identified by the total turnover, speed or pace of internationalization and the scope (Senik, 2010). Despite the many concepts associated with the radical internationalization models the most prominent ones are Born Global and International New Ventures (Hammoudi, 2005). While the incremental internationalization model draws its foundations from economic theory, organization theory and marketing theory (Johanson and Vahlne, 1990). Within this perspective, internationalization processes posit that firms move into foreign markets through gradual development and in distinct stages (Cavusgil, 1980; Johanson and Vahlne, 1977).

Application of Internationalization Theories/ Models

The rise of Born Global SMEs challenges the traditional internationalization theories (Knight and Cavusgil, 1996) and also affects the public policy in many countries (Bell and McNaughton, 2000). Therefore, Bell and McNaughton (2000) suggest government involvement in international trade policy and industrialization in relation to SMEs be aimed toward value-added products/ services and knowledge-based economy.

The practical application of the incremental models and in particular the Uppsala model, have been examined in many studies. The 'Uppsala" model conceptualize the internationalization process through four incremental steps, which are: 1) the firm starts in the domestic market and has no regular export activities; 2) after establishing a strong domestic market it starts exporting via independent representatives (agents); 3) establishment of a sales subsidiaries in the foreign market; and 4) establishment of a production or manufacturing subsidiary in the foreign markets. Some studies strongly support and indicate the incremental approach was the most commonly applied theoretical framework. Although, Johanson and Vahlne (2003) believe their model is still applicable, they advocate a new approach to meet today's technology challenges and global competition.

Previous Research

Several literatures are used in supporting this study. They provide the grand concept and link between the previous research and this research. Lu and Beamish (2001) discusses the effects of internationalization, an entrepreneurial strategy employed by small and medium-sized enterprises (SMEs), on firm performance. They found that alliances with partners with local knowledge can be an effective strategy to overcome the deficiencies SMEs face in resources and capabilities, when they expand into international markets. Deakins et al. (2013) revealed that successful engagement depends on the ability of the management to recognize and exploit opportunities and ultimately commit resources towards building international markets. Vasilchenko and Morrish (2011) described that the existence of relationship networks can be a source of internationalization opportunity. Thus, entrepreneurs take advantage of all the various networks forms throughout the different stages of the internationalization process.

Conceptual Framework

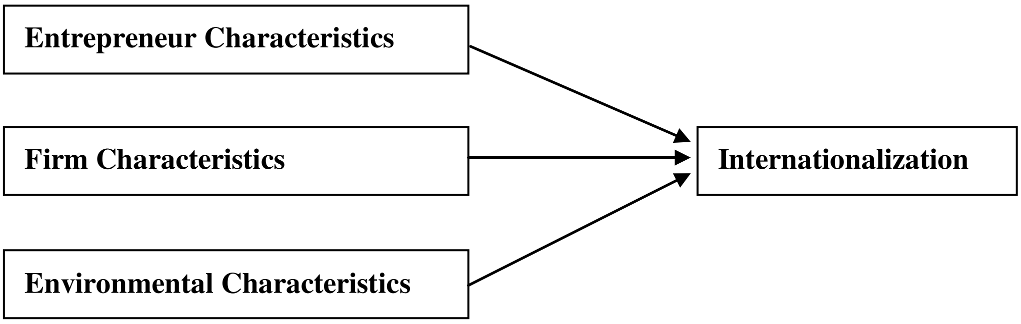

Figure 1. Conceptual Framework
Source: Theoretical Review

The diagram above explain the key drivers affecting internationalization through entrepreneur characteristic, internal factors which is firm characteristic and external factors which is environmental characteristic.

RESEARCH METHOD

Type of Research

This study was performed a qualitative method. Sekaran and Bougie (2009:29) suggested that qualitative data refer to information gathered in a narrative form through interviews and observations. Qualitative data are in the form of words and interview, or in other words means language. Examples of qualitative data are interview notes, transcripts of focus group, answers to open-ended questions, transcriptions of video recordings, accounts of experiences with a product on the internet, news articles, and so on. The other type of this study is a descriptive method which did not seek to measure the effect of variables but to describe what will happen or how it is happening. According to Sekaran and Bougie (2009:105) a descriptive study is undertaken in order to ascertain and be able to describe the characteristics of the variables of interest in a situation.

Place and Time of Research

This study was conducted in Manado between January to March 2014

Data Collection Method

Data collected in this research was from secondary sources. The secondary data was collected from books, articles, web, and e-books. Sekaran and Bougie (2009:84) said that, "Secondary data refer to information gathered by someone other than the researcher conducting the current study." There are several sources of secondary data, including books and periodicals, government publications of economic indicators, census data, statistical abstract, databases, the media, annual reports of companies, etc.

Method of Analysis

Qualitative Method

Sekaran and Bougie (2009:369) stated that qualitative data are in the form of words. Examples of qualitative data are interview notes, transcripts of focus group, answers to open-ended questions, transcriptions of video recordings, accounts of experiences with a product on the Internet, news articles, and the like. Qualitative data can come from a wide variety of primary sources and /or secondary sources, such as individuals, focus groups, company records, government publications, and the Internet. The analysis of qualitative data is aimed at making valid inferences from the often overwhelming amount of collected data". Qualitative data can give data, information, meaning, and objective or purpose in certain condition.

Descriptive Method

Sekaran and Bougie (2010:105) stated that: A descriptive study is undertaken in order to ascertain and be able to describe the characteristics of the variables of interest in a situation".

RESULT AND DISCUSSION

Result

Factors influencing SMEs internationalization

(a) Entrepreneurs' Characteristics

Many decisions in small firms depend on the personal characteristics of the owner-entrepreneur, include the decision to become an international business. The recognition and exploitation of opportunities are neither self-evident phenomena nor matters of chance, but are a result of clear, positively motivated business intentions and actions on the part of the owner-entrepreneur, driven by the belief that (s)he can produce the desired outcomes (Gray 2000; Maki and Pukkinen 2000). Based on the literature, personal characteristic of key personal or owner-entrepreneur include previous experience particularly at the international level. This could be gained through foreign work experience, education abroad, affluent background and demographics. Key personnel who have experienced living abroad are more likely to seek involvement in international business than those who have not (Bell et al., 2007).Personality traits, such as good interpersonal skills, honesty, tolerance and trustworthiness may also act as determinants of internationalization.

To deal with the complexity in uncertain conditions of international markets, individual are more likely to rely on previous experiences. The entrepreneurs' experiences gained exposures through attending overseas training and workshops, participating in international events, or experiencing overseas attachment through study, work or travelling.

(b) Firm Characteristics

Firm size affects internationalization behavior (Olivares-Mesa et al., 2007) while firm age influences the pace or speed of a firm's internationalization (Zahra & George, 2002).Another factor like firm's resources significantly becomes the most important influence on the internationalization process. A firm must be strong financially accompanied with a good banking relationship and had adequate physical resources to support their international expansions. The existence of key employees, especially technical staff who promote the product or service, must be capable, educated and competent to deliver proper design and quality for overseas customer. Furthermore, several factors such as upgraded technology, production capabilities, accessibility to raw materials, availability of R&D facilities, and the location of the production site were crucial for internationalization (Senik, 2010:276).The need to be technologically competitive brings in the modern process of production and high-quality system. It is also accompanied with source of raw material of the company which is unable to duplicate or accessed by any potential competitor.

(c) Environmental Characteristics

Root (1994) argues that environmental characteristic in the form of political, economic, social, technical and legal requirements at home and in the target country also affects internationalization process.The firm needs to be alert to changes in the environment and if necessary, it must adapt to these changes (Gartner, 2005). Studies show that dynamic environments have a positive influence on firm internationalization, when compared to static environments (Dess, et al, 1997; Zahra, 1993).

Discussion

The process of internationalization

(a) Stages of development models

The early stage development of firms internationalization theories have focused on exporting and FDI activities. Some firm gradually strengthen their position in the domestic market before entering the foreign market. Started with the position where a firm has no regular exports activities, firm began enter the international market through overseas customer approach looking to source of product or service.Through the overseas customer demands, the companies start to export their products or service by utilize traditional exporters in mature markets. This is where the company has entered the international market. They would subsequently formalize their entries through deals with intermediaries, often agents who represented the focal companies in the foreign market (Johanson and Vahlne, 2009). As sales grew, usually firms will replace the sales agent in the foreign market with their own sales organization. Moreover, as growth continued the companies would begin to manufacturing in the foreign markets to overcome the trade barriers and the difficulties associated with the liabilities of foreignness.

(b) Network-based approaches

In the context of internationalization, an effective use of networks enables companies to overcome barriers, such as relatively small company size, lack of internal resources, and distance from international markets, to both innovate and execute on the global stage, creating increased export revenues (Chetty and Wilson 2003; Kelly 2000; Oviatt and McDougall 1994).Bell et al. (2003) states the relationship between networks and SMEs internationalization is such that 'internationalization is seen as an entrepreneurial process embedded in an institutional and social web which supports the firm in terms of access to information, human capital, finance and so on'.Network approaches could be relations with other firms or customers, suppliers, institutional agencies, competitors, financiers and so forth. This networking form sometimes facilitated by international trade shows and various industry events. However, it is also established by entrepreneur experience in overseas.While SMEs forms relationship in domestic and overseas markets, knowledge domain from which their products or services are developed. The firms also need to build trust with one another and reduces the risk. In addition, the flexibility of networks can compensate for some disadvantages of licensing and alliances. Prior research on alliances points to several benefits including the minimization of transaction costs, increased market power, shared risks and better access to key resources such as capital and information (Kogut, 1988). For SMEs, foremost among these benefits is access to the partner's resources, or 'network resources' (Gulati, 1988).Overall, the use of firm's resources and information possessed by networks altogether the implication of firm's knowledge, allow the companies to develop internationalization opportunities.

(c) Resources-based strategies

The successful engagement in international markets depends on the ability of the management in a firm to recognize, set the appropriate strategies and exploit opportunities by consider the availability of resources. Firm resources include all assets, capabilities, organizational processes, firm attributes, information, knowledge, and so forth. These numerous of resources controlled by a firm, enable the firm to conceive of and implement strategies that improve its efficiency and effectiveness. The resources-based strategies is when a firm implementing a value creating and rational strategy to internationalization which not simultaneously being implemented by any current or potential competitors. The firms are implementing the right strategy along with the utilization of availability of resources could potentially create the innovative product to enter the international markets. This type of firm goes into international markets right from their birth, or known as "Born Global" firms.Firms with new innovation are also forced to internationalize quickly in order to benefit from first mover advantage.

Case Selection

This study provides an example the internationalization process of two small and medium enterprises in New Zealand and Indonesia. The first is Elis Fibre Ltd – New Zealand, a successful company in the development and marketing of a range of products using wool, aromatherapy and magnetic therapy to promoting healthy sleep. Elis Fibre has increased its output and exports to Australia, Korea, the UK and Europe. The second is Traditional Wooden House – Indonesia, a successful craft company that offers sales Minahasa Knock-Down Wooden House / Manado, Wooden Gazebo, Wooden Furniture, Wood Furniture (sills, window, door, etc.) and other wood-based building (e.g. office, villas, cottages, etc).In 2012, the wooden house production recorded an increase in exports to the country of Tanzania and Dubai, United Arab Emirates with 80 units. The overall purpose of this example is to build a deeper understanding of the process, performance and key challenge faced by the companies in order to enter the overseas market.In summary, we conclude as follow:

Table 3. Summary of SMEs Cases

Internationalization	Elis Fibre Ltd.	Traditional Wooden House
Mode	Export-oriented (representative agent/ sales in foreign markets)	Export-oriented (traditional exporters or local agents in mature markets)
The Process	Network-based	Resource-based
Factors Influencing	Entrepreneurial experience in foreign markets (participating in international event)	Enquiries from overseas and management good predictor of export behavior
Challenges	Ensure quality standards are maintained and delivery made on time.	Limited resources of raw material and tyranny of distance
Performance	Having rare, imperfectly imitable and non-substitutable resources and capabilities	Product reputation significantly increased

Source: Elis Fibre Ltd and Traditional Wooden House

CONCLUSION AND RECOMMENDATION

Conclusion

The conclusions of the research are as follow:

1. In general the factors influencing SMEs internationalization include entrepreneurs' characteristics, firm characteristics and environmental characteristics. In summary can conclude as follow:
   a) Entrepreneurs' characteristics: foreign education or work experience, positive attitudes, motivations and expectations.
   b) Firm characteristics: management commitment, high-tech and knowledge-intensive.
   c) Environmental characteristics: size and scope of market, information and business support availability.

2. Along with those influencing factors, the process of internationalization lies in three distinctive ways, as follow:
   a) Stages of development model, product/ export oriented.
   b) Network-based approaches, form relationships in domestic and overseas market.
   c) Resource-based strategies, rational strategic management approach to internationalization.

Recommendation

Turning now to internationalization process, it seems reasonable to suggest that, first, when SMEs make decision to enter the foreign market, the entrepreneur should have a previous experience particularly at the international level to exploit the liability of foreignness. The entrepreneurs' experiences gained exposures through attending overseas training and workshops, participating in international events, or experiencing overseas attachment through study, work or traveling.In addition, the presence of personal networks in foreign markets made it easier for entrepreneur to enter such markets. Second, a firm must be strong financially, implement the right strategies such as size and scope of markets, and the existence of key employees or human resources. Third, a firm needs to be alert to changes in the environment such as political, economic, social, technical and legal requirements at home and in the target country.

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