

Understanding the Effect of Home Country Institutional Pressures towards Internationalization Strategies among Malaysian SMEs

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ARTICLE INFO

Article history:

Received in revised form January, 5
2018

Accepted April 2018

Keywords:

Home country institutional pressures;
Internationalization strategies; SMEs

ABSTRACT

A challenging business environment nowadays made small business especially SMEs think twice before planning to initiate international business. With lacking of knowledge and experience in handling international market activities, makes most SMEs faced difficulties starts from home country obstacles as well as host country. This study tends to understand the consequences of home country institutional pressure on internationalization strategy. In this research, purposive sampling was used in selecting 860 SMEs as the sample from the registered list of companies in the Federation of Manufacturing Companies (FMM) directory, which is the most comprehensive list of SMEs database. The Partial Least Square (PLS-SEM) was used as the statistical tool to measure the significance relationship between construct. The major findings were proven the significance of the relationship and confirmed the importance of understanding the home country institutional pressures and internationalization strategy choices.

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1 INTRODUCTION

Small business internationalization is an important element of economic development and firm growth especially for emerging countries which is now trending in international business research. Internationalization activities give benefit to the economic growth and for country's well-being and international reputation. Internationalization is an essential strategic choice for small firm growth (Skrt & Antoncic, 2004). For small and medium-sized enterprises (SMEs), internationalization is an entrepreneurial activity and entering new geographic markets can be regarded as, on a large scale, the act of adopting new practices.

Most of SMEs nowadays in developing countries such as Taiwan and Singapore are generating earnings in the global markets more than in the home countries. These firms, can also categorize as 'born global' or 'instant internationals' (traditional SMEs which enter international field almost from inception), 'backsources' (SMEs who re-concentrate their international activities back to the home base) and 'born regional' (SMEs that gain their force out of a local embeddedness and never shift capacity beyond export activities) (Schulz, Borghoff & Kraus, 2009). There have been many researchers conducted on internationalization of SMEs in emerging economies such as China (Ahlstrom, Bruton &

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<http://dx.doi.org/10.1018/j.jarims.2018.10.018>

Yeoh, 2008), India (Saini & Budhwar, 2008), Taiwan and Singapore (Sim & Pandian, 2003; Cheng & Yu, 2008) and Vietnam (Thai & Chong, 2008).

Extending earlier findings, some researchers showed that firms decision will be influenced by the context in which they are set up (Scott, 1995), the institutional pressures existing in the home country. These kinds of environment are most likely to push SMEs to initiate internationalization (Cheng & Yu, 2008). Besides, SMEs will engage in internationalization through carefully planned stages (stage model) due to lack of resources and advantages. In contrast, other SMEs can be quite radical in some instances. For example, study by Zahra et.al. (2005) showed that SMEs will go abroad for the cognition of pursuing new opportunities that allow them to leverage their core competencies across markets. Besides earlier discussion, SMEs who initiate to internationalize is influenced by the networks of inter-organizational and inter-personal relationships in which firms are embedded.

Although internationalization can indeed be regarded as an opportunity-seeking choice on the part of firms, it may also represent a critical decision to the costs and risks involved. Firms expanding abroad should have strong ownership advantages if they are to successfully overcome the disadvantages of operating in host countries. When SMEs make their initial entry into international markets, they are especially prone to problem associated with the liability of foreignness, which may lead to poor financial performance and a variety of other concerns for managers (Bell, 1995; Lu & Beamish, 2001).

2 PROBLEM STATEMENT

Small and medium-sized enterprises (SMEs) play an important role in any economy around the globe where they reduce unemployment. Malaysia is not an exception; SMEs are considered as the main contributor to the economy. Past studies showed that 13 per cent of SME businesses were no longer in operation in 2005 after only five years of their establishments (Abdullah, Deen, Saban & Abdurahman, 2009). In fact, the rate of failure among SMEs in Malaysia is as high as 60 per cent (Domestic Trade and Consumer Affairs Ministry, 2011). Although manufactured goods were the highest component in export industry, it showed inconsistency in export growth from early 2014 until 2015 (Department of Statistics Malaysia, 2015).

Recently, home country environment has been recognized as one of the push factors that initiate small and medium-sized firms' ability to survive in export market. SMEs may be motivated to enter the international market due to the internal realization that it can gain access, in the process to technology, capital, supply chains, knowledge or growth opportunities to achieve the economies of scale etc. This study would like to call this factor collectively as home country institutional pressures, thus, attempt to explore the significance of this factor towards the internationalization strategies among Malaysian SMEs.

Overview of Malaysian SMES

SMEs have long been recognized as the backbone to any economy as they have been an important generator of

employment and growth. Similarly in Malaysia, SMEs account for about 99% of total business establishments and contribute 5.2 per cent (1996-2005) 40 percent for 2006-2010 of the nation's Gross Domestic Product (GDP) (New Straits Time, June 2010). SMEs shares of total employment and export of the country are 56% and 19% respectively. Going forward in order for Malaysia to achieve a developed nation and high income status, domestic SMEs are expected to be an important driver of growth.

In order for local business to grow and contribute towards a vibrant economic environment especially among SMEs, the government has in place a support structure that helps create a dynamic business environment. Government authorities such as the Malaysian Entrepreneurship Development Centre, SME Corporation, Multimedia Development Corporation (MDeC) have outlined various measures towards creating a more conducive business environment in the country. Like Malaysia External Trade Development Corporation (MATRADE), the national trade promotion agency by 'selling' Malaysia' enterprise to the world, formulates marketing strategies and trade promotion activities to support Malaysia's export and position the country as a globally competitive trading nation. (www.matrade.gov.my)

In term of fostering growth of business, The Special Taskforce to Facilitate Business (PEMUDAH) was formed in improving the existing government processes and regulations based on public feedback and global benchmarking reports, to improve processes pertaining to land matter, licenses, employing expatriates and paying taxes. (www.pemudah.gov.my)

Funds are also made available through financial institutions including Bank Negara, Bank Simpanan Nasional, Agrobank Malaysia, SME Bank, Credit Guarantee Corporation Malaysia Berhad and Export-Import Bank Malaysia Berhad (EXIM Bank). In addition, to trigger more innovation from local business, the Malaysian Intellectual Property Corporation (MIPC) in providing services in administering, supervising and handling the management of intellectual property and promotes the registration of business inventions and creations in order for intellectual property to be protected by law.

3 LITERATURE REVIEW

Home country institutional pressure

When considering the influence of external social, technical, and political environments on organizational behavior, institutional theory is especially salient. In contrast to transaction cost economics and resource dependence theory (Pfeffer & Salancik, 1978), institutional theory posits that structural and behavior changes in organizations are driven less by competition and the desire for efficiency, but more by the need for organizational legitimacy. This is drive for legitimacy that fosters the processes of internationalization which eventually makes organizations more similar without necessarily making them more efficient which is giving rise to institutional isomorphism (DiMaggio & Powell, 1983).

Given that small businesses adapt to their institutional environments in many different ways as Bell and Cooper (2018) commented on Brouthers (2002) study that the influence of institutional and cultural context differences on

entry modes in internationalization and concluded that firms prefer to enter more socially, politically and economically stable institutional markets.

It is supported by the study of DiMaggio and Powell (1983) identify three basic types of institutional isomorphism, namely *coercive*, *mimetic* and *normative*, which reflect three analytically distinct processes of institutionalization. Coercive isomorphism results when organizations acquiesce to “the formal and external pressures exerted upon them by other organizations upon which they are dependent, and the cultural expectations in the society within which the organizations function” (DiMaggio & Powell, 1983, p. 150). *Coercive* pressures can also arise from government regulations and policies and from industry and professional networks and associations, or in the form of competitive necessity within an industry or market segment (Gular et.al., 2002; Mezas, 1990). For example, a given legal restriction, whether originating in the home country or the host country, can jointly act to affect a firm’s international expansion (Davis, Desai & Francis, 2000) and to limit (or not limit) a firm’s choices with regard to internationalization.

Mimetic isomorphism results as organizations respond to uncertainty by mimicking actions of other organizations. When technologies are poorly understood, when goals are ambiguous, or when the environment creates uncertainty, organizations may model themselves after other organizations perceived to be legitimate or successful (DiMaggio & Powell, 1983). Firms have been found to imitate one another’s patterns of internationalization, with respect to such actions as the sequence of entry, entry timing and entry mode (Guillen, 2002; Meyer, 2001). As has been suggested in the literature, a firm’s resistance to the current trends in its environment may lead to fears of failure in a competitive context; thus, SMEs will tend to mimic the new practices in which their peers are engaging in (Kraatz, 1998).

Therefore, mimicry is often associated with the bandwagon effect (Staw & Epstein, 2000). Several empirical studies observe mimetic isomorphism in the decision making processes (Haveman, 1993; Staw & Epstein, 2000). *Normative* isomorphism occurs primarily as a result of professionalization defined as “the collective struggle of members of an occupation to define the conditions and methods of their work, to control the production of the future member professionals, and to establish a cognitive base and legitimization for their occupational autonomy” (DiMaggio & Powell, 1983, p. 152). For a particular industry, it is argued that a pool of almost interchangeable employees is created through formal education and professional networks. By occupying similar positions across a range of organizations, these individuals possess similar orientation and disposition that override the variations in traditions and control mechanisms otherwise shaping distinctive organizational behavior.

Internationalization Strategies

Internationalization is the most complex strategy that any firm can undertake. This strategy is likely to become increasingly necessary. Owing to the growing market globalization, SMEs specifically may have to face this strategy. Therefore, it seems advisable that more effort should be devoted to studying forms of international expansion for SMEs and how to improve

them.

Internationalization strategy has been documented in different countries by a large body of both theoretical and empirical studies. However, little attention has been paid to examine this strategy in consequences to home country institutional pressure. Studies on SMEs that dealing with difficulties stemming from different of strategies is still limited.

A study by Agndal and Sylvie (2007) argued that, when a firm gets involved in internationalization whereby a process of global activities of a firm has resulted there are many ways of setting up their global strategy. As noted from a management perspective, the business strategy is referred as a guideline for the firm to sustain when penetrating foreign markets, in setting up strategies for organizations and functional management, marketing as well as diversification strategies.

This study focuses on four main strategies that have been adopted by the SMEs in Malaysia. It consists of mode of entry, target market, product adaptation strategy and market spreading strategy. As far as international business is concerned, *the mode of entry* is a critical element of a firm' in determining their internationalization strategy. Acs et.al (2001) suggested the classification of direct entry modes and intermediated or indirect entry modes. For the purpose of this study, exporting involved. In export activity, firms are given two channel options: (a) export directly to the international market or (b) export indirectly through intermediary (Peng & York, 2001). Peng and York (2001) defined intermediaries as agents and distributors which is located either at home or abroad.

By choosing intermediaries as a medium of internationalization, SMEs formed a strategic linkage with large foreign firms to overcome problems due to the liability of newness, foreignness ad small size and to enable access to foreign markets, technology and reputation as well (Kuemmerle, 2002). However, it still leaves SMEs with several disadvantages such as a lack of full awareness of the market, unable to access the flow of ideas and extraordinary rent appropriation. Due to that matter, export intermediaries play a crucial role in international trade by connecting individuals and organizations especially those in other countries (Peng & York, 2001).

On top of that, the distance that occurs in *target market* determination will implicitly reflect on the level of knowledge. As Ruzzier et.al. (2007) argued that when the distance between home and host country is greater, the huge differences in the firm's level of knowledge about targeted country will become smaller when it is related to the international involvement. However, if the target foreign market is much similar to the domestic market, it is less risky to enter those markets as market knowledge is transferable and the transition is much smoother from one market to another (Shrader et.al., 2000).

Product adaptation is a special case of product-line extensions to foreign markets. Product adaptation strategy as a firm’s consistent and planned activities to meet local consumers’ preferences and values (Cavusgil and Zou, 1994). In other words, product adaptation is needed whenever a firm get involved in international business in order to fulfill local customer preferences. This strategy is primarily determined by

characteristics of the firm and external business environments (Leonidou et al., 2002;Menguc, 1997).

Scholars have advocated the factors that favor the strategy of adaptation, including the type of the product (products that vary according to markets specificity), the variation of the purchasing power of the consumers, standards and norms set by the foreign market, important cultural differences with regards to traditions, language, habits and practices of the consumers of the competing country. In this respect, there is no better strategy. But the adopted strategy depends, among other things, on internal and specific forces related to a company (Julian and O’Cass, 2004; Katsikeas et al., 2000; Theodosiou & Leonidou, 2003; Cavusgil & Zou, 1994).

Market spreading is measuring the geographical scope of a firm. The market spreading strategy involves two ways which is a sprinkler strategy (diversification); targeting multiple countries at one time and waterfall strategy (concentration); slowly pouring from one country to the next. Recently, few firms are able to internationalize simultaneously in all regions because of the high sunk cost of acquiring resources. Specifically for newly established SMEs, a global approach is not a perfect option. Normally, SMEs are likely to commit internationalization via gradually moving from entering more advanced countries and later stage to less developed countries. According to Sluwegen and Onkelinx (2010) by using a sprinkler strategy, firms are able to exploit economies of scale in research and development (R&D) and manufacturing in order to maximize firm’s revenues. Moreover, this strategy also may anticipate competitive moves in some countries, hence maximizes sales and market share.

4 METHODOLOGY

The scope of this study is among Malaysian SMEs. The reason for choosing Malaysian SMEs as the sample because, Malaysia is an emerging economy country; most businesses are SMEs but only small percentages are involved in exports. In this research, purposive sampling is used in selecting 860 SMEs as the sample that gathered from the registered list of companies in the Federation of Manufacturing Companies (FMM) directory, which is the most comprehensive list of SMEs database. The study used SMEs in Malaysia, including Peninsular Malaysia as a sampling population. Only 124 of respondent received and usable were used for data analysis.

The questionnaire was distributed to the respondents of the identified company via mail. The questionnaire and a self-addressed return envelope are mailed to all the respective companies which are the targeted respondents of the study.

The study, aims to gain insight into the significance of the relationship between home country institutional pressure and internationalization strategies of Malaysian SMEs. The SmartPLS 2.0 statistical tool was chose to test the significance of the relationship. The structural model path coefficient was conducted in order to look at the relationship among the construct. The path coefficients values between -1 and +1 which infer as strong positive relationships to negative relationship. The closer the value of estimated coefficients to 0, the weaker the relationship are.

5 RESULTS

Table below presents the result generated from the hypothesis testing on the relationship between home country institutional pressures and internationalization strategy. To test the hypothesis between construct, first order construct path analysis in main structural model was applied.

Table 4.1 Summary of Hypothesized Structural Relationship between Home Country Institutional Pressures and Internationalization Strategy

Hypothesis	Relationship	β	S.E	T	Supported
H1	HCIP->IS				
H1a1	HCIP1->IS1	-0.206	0.101	1.912**	Yes
H1a2	HCIP1->IS2	-0.191	0.099	0.519**	Yes
H1a3	HCIP1->IS3	-0.201	0.119	1.670**	Yes
H1a4	HCIP1->IS4	-0.077	0.126	2.025**	Yes
H1b1	HCIP2->IS1	0.198	0.118	1.962**	Yes
H1b2	HCIP2->IS2	0.096	0.111	1.127	No
H1b3	HCIP2->IS3	0.275	0.127	2.272**	Yes
H1b4	HCIP2->IS4	-0.135	0.124	0.960	No
H1c1	HCIP3->IS1	-0.201	0.144	1.705**	Yes
H1c2	HCIP3->IS2	-0.057	0.141	0.641	No
H1c3	HCIP3->IS3	-0.146	0.139	1.152	No
H1c4	HCIP3->IS4	0.009	0.161	0.193	No

Note: (**) Significant at $p < 0.05$ denotes as one-tailed t-statistics table, with t-value greater than 1.65

Based on table above, individual constructs of home country institutional pressures were represented by HCIP1 (coercive), HCIP2 (mimetic) and HCIP3 (normative), while internationalization strategies was measured by mode of entry (IS1), target market (IS2), product adaptation (IS3) and market spreading (IS4). The results show that home country institutional pressure has a significant relationship with internationalization strategies at significant value of $p < 0.05$. Of these hypotheses, 8 sub-hypotheses are significant. Two sub-hypotheses indicate highly of a relationship with internationalization strategies with T value at 2.025 and 2.272. The coefficient value of these two variables is 0.275 for the

relationship between mimetic institutional pressure and product adaptation strategy, and -0.077 for coercive institutional pressure and market spreading strategy. However, there are 5 sub-hypotheses with a not significant relationship with internationalization strategies, namely; mimetic institutional pressures and target market strategy (HCIP2->IS2), mimetic institutional pressure and market spreading strategy (HCIP2-> IS4), normative institutional pressure and target market strategy (HCIP3->IS2), normative institutional pressure and product adaptation strategy (HCIP3->IS3) and normative institutional pressure and market spreading strategy (HCIP3->IS4).

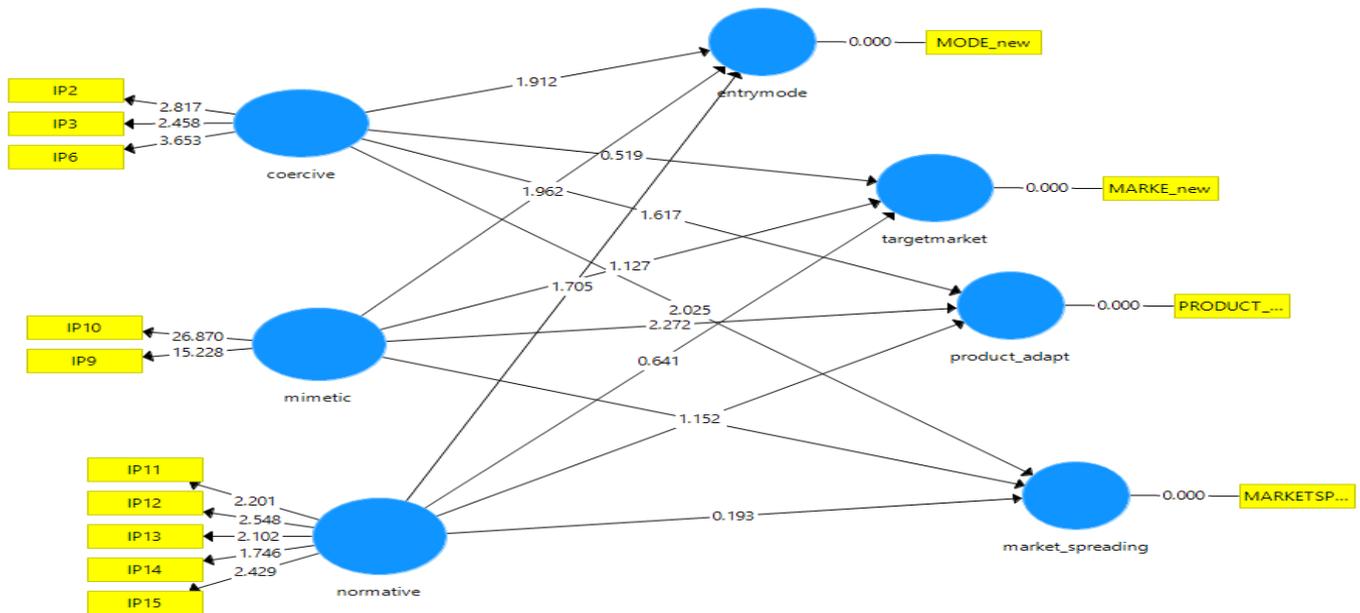


Figure 1: PLS result for hypothesis testing

6 DISCUSSIONS

Emerging market economies are known to have a variety of institutional environments as compared to developed markets. Managers, who are responsible as a strategic decision makers are likely to have been influenced by the complexity and uncertainty of the environment surrounding them. Besides, they also have to understand the business practices of the environment in developed economies too. As Goitom and Clemens (2006) noted government support programmes are crucial in fostering small firms especially in international markets. This can stimulate national exporters and may affect the SMEs internationalization process.

In the Malaysian context there is continuous support from the government in pushing Malaysian SMEs to involve in international markets. MATRADE for instance, gives a lot of support in helping SMEs in promoting their products. It is proven by Czinkota and Ronkainen (2007) that, the government assistance programs are focused on giving and motivating firms to excel in global activities and act as a push factor for local companies to initiate in international business environment.

Previous studies have identified that firms' political connections with the government will influence the profitability of the firm. It showed that a good relationship with government agencies will continuously improve a positive relationship and enable the firm to overcome any institutional negatives (Peng. et.al., 2005). Then, firms become more likely to expand when they have available and reliable information about a potential market, partly through observing other firms which they are familiar with (Fabian, Molina & Labianca, 2009). From the results, it is justified that home country institutional pressures will influence the internationalization strategy among Malaysian SMEs.

However, mimetic and normative pressures do not support target market and market spreading strategies. It is due to the government support such as the Malaysia Institute of Exports in providing training for Malaysian exporters and also information on target export markets (10th Malaysia Plan Report) that these strategies succeed. As far as educational background is concerned, the majority of SME owners are not well educated in the business environment, especially in how to gain exposure export venture activities.

Besides, a study by Hashim (2011) suggests that the apparent causes of failure in a small business such as inadequate sales, excessive fixed assets and inventories, poor location and premature business expansion resulted from the owner's inefficiency and inexperience in managing a business venture.

With regards to the negative influences of normative pressure on a target market, product adaptation and market spreading, this could be due to personal characteristics such as age and formal education but playing a less important role in small entrepreneurial companies. From the observation, the owners of these companies may have accumulated a lot of informal education and experience that may compensate for their lack of formal education (Brouthers & Nakos, 2005).

Further, this study conclude that owners/ senior leadership of early internationalizing firms are responding to an 'internationalization premium'; whereby companies tend to perform better than their counterparts that remain focused entirely on the home market. This internationalization premium is made possible by lower cost and ubiquity of information, networking with and learning from international partners, and efficient logistics. Information technology allows young companies to design and produce customized products they can target to narrow, cross-national market niches.

Based on Tan (2008) and Xia et.al. (2007) supported that small firms from emerging economies may have to rely on networks to overcome their isolation in the current globalized

market. Abdul Ghani et.al. (2009) also agree that networking is crucial for Malaysian SMEs to expand into foreign markets, while managerial skills (normative elements) were less necessary. Close relationships among the government, foreign partners, financial institutions and business are vital in exploring business opportunities abroad (Syed Zamberi, 2014).

7 CONCLUSION

In conclusions, the findings provide evidence that validated earlier studies. Results clearly suggest the important of SMEs especially manager to take into consideration the relevant strategy that might hinder failure to their business operation. Manager itself should have some knowledge on operating business in worldwide and did some research on particular markets that they intend to expand. Besides, government involvement in helping local entrepreneurship is highly recommended. Accessible and less bureaucracy procedure environment are really helpful to entrepreneurs in expanding their business globally.

8 ACKNOWLEDGEMENTS

The authors acknowledge comments from the audiences at the International Conference of International Business 2017. The authors also wish to thank Federation of Manufacturing Malaysia (FMM) for the provision of the SMEs database used in this paper.

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