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EXPLORING THE INTERNATIONALISATION OF SMALL TO MEDIUM-SIZED ENTERPRISES (SMES) IN
MALAYSIA: A PRELIMINARY FINDING

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ABSTRACT

This working paper reports a study that focuses on the internationalization processes of manufacturing SMEs in Malaysia. It attempts to discover why these firms internationalize and how the process of internationalizing takes place. A qualitative methodology using a modified Delphi approach of tele-conversation survey was taken for collecting data from a panel of expert. These experts drew attention to domestic and global conditions, government's incentives and support, firm specific factors, key managers' background and attitudes, and networking as the main issues contributing to the internationalization process of SMEs in Malaysia.

INTRODUCTION

The internationalization of small and medium sized enterprises (SMEs) is a growing and vital trend as increasing numbers of SMEs become involved in international trade (Camino and Cazorla, 1998; Lamb and Liesch, 2002). Extensive research into the internationalisation process of SMEs has been undertaken in western developed countries (Coviello and Munro, 1997; Gemser, Brand and Sorge, 2004; Leonidou & Katsikeas, 1996; Moen and Servais, 2002; Wickramasekera, 2004); however, relatively few studies have examined this process in developing countries (Das, 1994).

Between 1992 and 1998, Coviello and McAuley (1999) reviewed the literature on the internationalization of SMEs and identified sixteen recent empirical studies. However, only one in Pakistan, was from a developing country (Zafarullah, Mujahid and Stephen, 1998), which supports claims that research of SMEs based in developing countries is still in an embryonic stage (Kuada and Sørensen, 2000). This finding raises the following questions: Firstly, is the internationalisation process of SMEs in developing countries different from developed countries? Secondly, are the driving factors that affect the internationalisation process of SMEs in developing countries similar to those of developed countries? Thirdly, who play important roles in the process of internationalizing the SMEs in developing countries? These questions need to be addressed as the lack of empirical studies warrants investigation because of the economic and social impacts of SME's within developing countries.

SMEs in Malaysia

Malaysia, located in South East Asia, is one developing country that is assisting SMEs to become international players. Within the last ten years, Malaysia has been transformed from a commodity-based producing nation to manufacturing and is geared toward becoming a fully industrialized nation by the year 2020 (SMI Business Directory, 2005). Today, the country is quite competitive in attracting direct foreign investments and is among the world's top 20 trading nations (FMM Directory, 2005) thus give SMEs opportunities to broaden their operations. The country has a limited local market and an option for growth is to capitalise on globalisation, economic co-operations and government incentives that assist internationalisation.

The growing role for SMEs in international activities is emphasised in Malaysias Second Industrial Master Plan (IMP2 1996–2005) and Eighth Malaysia Plan (8MP 2000–2005). The government has a number of supporting agencies, such as the Small and Medium Industries Development Corporation (SMIDEC) and Malaysia External Trade Development Corporation (MATRADE) to offer support in various forms. For example, an industrial linkages programme (ILP) and Global Supplier Programme (GSP) introduced by SMIDEC assist SMEs to become industry suppliers. These programmes link the Malaysian SMEs with large local or foreign corporations, and push them to internationalize by subcontracting, exporting, and collaborating through joint ventures, licensing or

franchising (SMIDP, 2002). MATRADE alternatively assists Malaysian firms to better position their products and services in the highly competitive global markets (MATRADE, 2004).

In Malaysia, SMEs are defined as “firms with annual sales turnover not exceeding RM25 million or full time employees not exceeding 150” (SMI Development Plan-2001-2005, p.31). There are 48,200 firms registered as SMEs from various sectors and these contribute to economic growth, social cohesion, employment and local development within Malaysia; in 2002 they injected RM50.8 billion into Malaysia’s GDP (The New Straits Time, May 7, 2002). The 8MP estimates that 93.8 percent of all manufacturing establishments in Malaysia are SMEs and combined these provide employment for 868,000 workers, and those SMEs participating in the ILP and GSP programs generate sales of RM115.6 million in 2002 (SMIDEC, 2002). These programs have been so successful that the Ministry of International Trade and Industry (MITI) is preparing the Third Industrial Master Plan (IMP3) to follow on from the IMP2, which will end in 2005. This will cover a 15-year period (2006-2020) giving substantial concentration to the development of SMEs and their international expansion (MITI, 2005).

There have been some studies on SMEs in Malaysia (Bell, Crick and Young, 2004; Bjerke, 2000; Moha Asri, 1999; Yusuf and Aspinwall, 2000) but none has focused on the internationalization process. This study takes the first step to understand this pertinent issue and aims to gain a better understanding of the internationalization process of SMEs in Malaysia. The next section presents the relevant literature, whereas the third and fourth sections present the methodology and findings respectively.

LITERATURE REVIEW

Definitions

Andersen (1997) defines internationalization as the process of adapting an exchange transaction to international markets. On the other hand Beamish (1990) defines it as a three stage process where firms start by increasing their awareness of the direct and indirect influences of international transactions on their future, before moving on to establish and conduct transactions with other countries. Calof and Beamish (1995) define internationalization as the process of adapting the firms’ operations, for example, the strategy, structure, and resources, to the international environment (p.116). This study adopts the definition suggested by Calof and Beamish (1995) because it conveys the idea of internationalization as being dynamic and adjustable.

Internationalization

Generally, researchers agree that theories of internationalization can be viewed from five approaches (Etemad, 2004; Reiljan, 2001; Roolah, 2002; Tornroos, 2003) which are economic, behavioral, network view, international new venture and international entrepreneurship. These approaches, their brief explanations and some examples of the model or theory are summarized in Table 1. Since the purpose of this study is to investigate the process of internationalization; therefore, the most relevant models were selected. Two models from the behavioral approach; the Uppsala Internationalization Process Model or U-Model and the Finnish POM Models as well as a third model from the networking perspective, were investigated.

Table 1: Approaches to Internationalization

| No. | Approach | Brief Explanation | Model/Theory |
|-----|---------------------|---|---|
| 1 | Economic Approach | Main focus in the international activities of foreign direct investments. Rooted in macroeconomic factors and reasoning in order to understand why firms started to internationalize. | <ul style="list-style-type: none"> ▪ The growth of firm theory (Penrose, 1959) ▪ The internationalization theory (Hymer, 1976) ▪ The product life cycle approach (Vernon, 1966) ▪ The Eclectic Paradigm (Dunning, 1988) |
| 2 | Behavioral Approach | Internationalization is hypothesized | <ul style="list-style-type: none"> ▪ The Uppsala Model (Johanson and |

| | | | |
|---|--------------------------------|---|--|
| | | to take place through incremental steps when entering new markets, which have a greater psychic distance | Vahlne, 1997, 1990; Johanson and Wiedersheim, 1975) <ul style="list-style-type: none"> ▪ The Finnish-POM Model (Luostarinen, 1979; Welch and Luostarinen, 1988) ▪ Innovation process Model (Rogers, 1962; Andersen, 1993) |
| 3 | Network Approach | Focuses on the relationships or connectedness of firms to others and has been utilized in explaining how and why firms internationalize their operations | <ul style="list-style-type: none"> ▪ Internationalization and the network model (Johanson and Mattson, 1988, 1990) |
| 4 | International New Ventures | Claims that many firms go into international markets right from their birth and disregard any kind of stages | <ul style="list-style-type: none"> ▪ Born Global (Knight and Cavusgil, 1996), ▪ Global Start-ups (Oviatt and McDougal, 1994), ▪ International New Ventures (Oviatt and McDougal, 1994) Criado, Criado and Knight (2004) |
| 5 | International Entrepreneurship | Described as “the process of creatively discovering and exploiting opportunities that lie outside a firm’s domestic markets in the pursuit of competitive advantage”. | <ul style="list-style-type: none"> ▪ International Entrepreneurship (Zahra and George, 2002, p.10) |

Source: Compilation from various authors

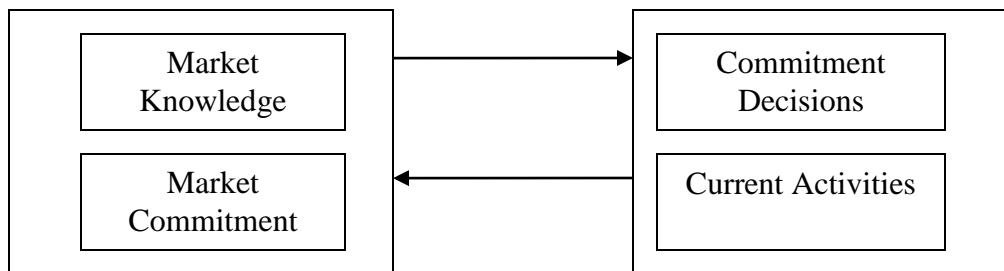
The U-Model initiated by Johanson and Wiedersheim-Paul (1975) and further developed by Johanson and Vahlne (1977 and 1990) is widely used to describe two patterns of internationalisation for small firms. Firstly, the internationalization process is developed incrementally, from no regular export activities, to exporting via independent representatives (agents), then moving into sales subsidiaries, before moving into production or manufacturing (Johanson and Wiedersheim-Paul, 1975; Johanson and Vahlne, 1990). This implies that firms make their initial entry into a market using a low risk and low commitment strategy, such as with direct exporting, before increasing to high risk and high commitment strategy via manufacturing subsidiaries and foreign sales. The second pattern is to enter new markets successively and start by going into countries with less psychic distances, in terms of language, education, business practices, culture and industrial development differences (Johanson and Vahlne, 1990; Hollensen, 2001). This suggests firms enter a particular market close to and similar to the home country before expanding into more distant and dissimilar markets.

The U-Model, presented in Figure 1, has four core concepts, which are market knowledge, market commitment, current activities and commitment decisions. These concepts link market commitment decisions to market knowledge and current commitments in the market (Johanson and Vahlne, 1990). It assumes sequential internationalisation is due to uncertainty about operating abroad because of the lack of knowledge, information and experience about foreign markets (Johanson, et al. 1977, p. 26).

Figure 1: The basic Mechanism of Internationalization – State and Change Aspects

State aspects

Change aspects



Source: Johanson, et al. 1977, p. 26

The U-Model has been criticized as being too deterministic; it does not include managerial competency (Burgel and Murray, 2000), cooperative modes, or leapfrogging (Anderssen, 1997; Hansson, Sundell and Ohman, 2004). Others suggest firms internationalize using a backward and forward momentum, rather than an incremental manner (Autio and Sapienza, 2000; Knight and Cavusgil, 1996). Some firms do enter distant markets with higher market commitment, which contradicts the U-Model (Hansson, et al. 2004). To overcome these weaknesses the Finnish-POM Model is also used in this study.

The Finnish-POM Model distinguishes three dimensions of internationalization (Luostarinen, 1979). First is Product (P), which describes ‘what’ in terms of firms’ goods, services, know-how and systems. Second is Operation mode (O) which relates to ‘how’ firms operate such as through agents, subsidiaries, licensing and management contracts. Third is Market (M), which describes ‘where’ in relation to the selection of markets and takes into account political, cultural and physical differences. The ‘organizational capacity’ dimension was later added describe organizational structure, resources, finance and personnel (Welch and Luostarinen, 1988). This model has been given little attention so far (Reiljan, 2004), despite providing in-depth dimensions lacking in the U-Model. Another important entry mode the models overlook is networking.

The networking perspective explains how relationships in business give firms a growth opportunity. The network involves “sets of two or more connected exchange relationships” (Axelsson and Easton, 1992). Different approaches have been taken to investigating networking; for example, Ford (2002) compared companies that use networking to internationalize, whereas Welch and Welch (1996) concentrated on networking linkages, such as governments, agencies and other firms, which assist the process. The network approach is convenient for explaining ‘why’ and ‘how’ firms internationalize (Johanson and Mattson, 1988) as networks influence strategic decisions and involve the exchange of resources among different members (Sharma 1993). Networking is a crucial for gaining knowledge and awareness of international opportunities.

METHODOLOGY

A qualitative approach using a modified Delphi study was chosen to gather opinions from a group of experts. Because interpersonal contact is valued in Malaysia, telephone interviews were chosen in preference to written answers. The purpose was to gather their views on the issues facing SMEs when they internationalize. Experts were selected because of their expertise in the areas of international business, strategic management, SME development and entrepreneurship and came from five categories, namely; expert academics (EA), policy makers (PM), supporting government agencies (SGA), a research institute (RI), and the Chamber of Commerce (CC) by their names and affiliations, which were identified from the internet.

Telephone surveys were conducted during September and October 2005. Thirty experts were approached by email or telephone, with a follow up letter outlining the purpose of the study, the questions, and requesting written consent for participating in the study. Of the 16 participants, 2 responded by email. Interviews lasted from 15 to 30 minutes. Interview information was hand recorded, and analyzed manually. In all, 14 males (88%) and 2 females (12%) participants, drawn from 5 categories [EA, 3 (19%), PM, 4 (25%), SGA, 4, (25%), CC, 2 (12%) and RI, 3 (19%)] participated in the survey. These experts ranged in age from their early to late 30s (3:19%), early to late 40s (9:56%) and early to late 50s (4:25%).

FINDINGS

The results of the expert survey are summarized in Table 2. The experts identified four predominant triggering factors for Malaysian SMEs to internationalize and these related to domestic conditions (75%), globalization (75%), market issues (69%), and resource seeking (50%). Two aspects they identified as important drivers were the firm itself, and key characteristics of top managers. They related four themes to the firm, these being resources (63%), product (63%), capability (44%), and reputation (31%). The three predominant characteristics of top managers identified were interpersonal skill (88%), attitude (75%), and background (69%).

Table 2: The Findings of the Telephone Survey

| Aspect | | Key Themes | Experts (%) |
|-------------------|-------------------|-------------------------------|-------------|
| 1. Reasons | | Domestic conditions | 12 (75%) |
| | | Resource Seeking | 8 (50%) |
| | | Market Issue | 11 (69%) |
| | | Globalization | 12 (75%) |
| 2. Firm | Firm Itself | Resources | 10 (63%) |
| | | Product | 10 (63%) |
| | | Reputation | 5 (31%) |
| | | Capability | 7 (44%) |
| | Key Managers | Attitudes | 12 (75%) |
| | | Background | 11 (69%) |
| | | Interpersonal Skills | 14 (88%) |
| 3. Industrial | | Intense competition | 14 (88%) |
| | | Market Attractiveness | 9 (56%) |
| | | Economies of scale | 8 (50%) |
| | | Nature of sectors | 6 (38%) |
| 4. External | | Political Forces | 10 (68%) |
| | | Economy | 11 (69%) |
| | | Society | 4 (25%) |
| | | Technology | 8 (50%) |
| 5. Relationships | | Institutions | 16 (100%) |
| | | Other players | 12 (75%) |
| | | Personal relation | 13 (81%) |
| 6. Challenges | | Political Wills | 5 (31%) |
| | | Management | 7 (44%) |
| | | Competition | 6 (38%) |
| 7. Barriers | | Resources | 11 (69%) |
| | | Financial | 12 (75%) |
| | | Attitude | 9 (56%) |
| | | Capability (R & D) | 9 (56%) |
| | | Political | 5 (31%) |
| | | Management | 10 (63%) |
| 8. Expect To Gain | | Profit making | 13 (81%) |
| | | Market | 11 (69%) |
| | | Learning | 9 (56%) |
| | | Competition | 5 (31%) |
| 9. Operation | Modes of entry | Exporting | 12 (75%) |
| | | Subcontracting | 11 (69%) |
| | | Others | 10 (63%) |
| | Markets Selection | Within South East Asia Region | 7 (44%) |
| | | Free Trade Zone Agreement | 3 (19%) |
| | | Neighboring countries | 10 (63%) |
| | | Others | 7 (44%) |

Source: Summarized from the telephone survey results

Four themes emerged in relation to the industry; including the intensity of competition (88%), market attractiveness (56%), economies of scale (50%) and the nature of sector or industry (38%). External environment factors included

the economy (69%), political forces (68%), technology (50%), and society (25%). The experts identified three main sources of networking which were supporting agencies, such as the government, the Standard and Industrial Research Institutions of Malaysia (SIRIM) Berhad, the Chamber of Commerce, universities and ministries, etc (100%); Personal relations through individual contact with friends, colleagues, students, families, etc. (81%); and other players such as either small or large and local or foreign firms (75%).

The SMEs face six barriers in internationalizing their firms; the largest of these is financial limitations (75%), followed by resource constraints (69%), management incompetence (63%), negative attitudes (56%), R & D incapability (56%), and political intervention (31%). To ensure successful internationalization, SMEs have to overcome three challenges. The first of these is lack of management experience in international markets (44%) competition (38%) and political forces (31%). The purpose of internationalization is predominantly to gain greater profit (81%), penetrate into new markets (69%), learn new skills and techniques (56%) and compete with others (31%).

In terms of entry modes and market selection, Malaysian SMEs prefer to internationalize predominantly by exporting (75%), subcontracting (69%), and other strategies (63%) that include strategic alliances, mergers and acquisitions, licensing/franchising, and setting up a subsidiary. They operate mostly within the South East Asia region (44%) within the free trade agreement zone (19%), in neighboring countries (63%) such as Thailand, Indonesia, Brunei and Singapore, and other markets (44%) such as Middle East, China, Sudan, India, Bangladesh, etc. Drawing on these findings the next section discusses the most influential aspects affecting internationalization of SMEs in Malaysia.

DISCUSSION

The majority of experts drew attention to domestic and global conditions, the Malaysian government's incentives and support, firm specific factors, key managers' backgrounds and attitudes, and networking, as the main issues contributing to Malaysian SME. These results imply that the internationalization process is complex and influenced by various factors and relationships within and outside the firm, supporting previous findings. Discussed below are the most influential aspects in the Malaysian SMEs internationalization which are the triggering factors, awareness of international opportunities, firm specific issues and entry mode and market selection.

Triggering Factors

The experts agree internationalization is triggered by domestic and global conditions. The Malaysian market is getting smaller as foreign firms can have competitive advantages to enter the country, Malaysian SMEs have to seek international opportunities to remain in business and survive. Globalization and the Asian Free Trade Agreement (AFTA) provide expansion opportunities, whereas the 'open door policy' of China presents greater challenges. Triggering factors such as the problem of saturated domestic markets and competitive pressures (Czinkota, Johanson and Ronkainen, 2002), industry conditions and globalization (Bloodgood, Sapienza and Almeida, 1996), and liberalization of international markets (Etemad, 2004) have been discussed in the Western literature and appear to present similar problems within the Malaysian context.

Awareness of International Opportunities

Internationalization starts with the awareness of the international market opportunities and Malaysian SMEs learn of these through government linkages, networking with other players and from personal contacts. Indeed, the key actors in the firms create networking with other domestic players, and then gradually move to international level through long-term relationships. However, some firms even make faster move by making networking with international companies' right from the start. This does not match Johanson and Vahlne's (1977) U-Model contention, which assumes information, is generated and processed within the firm. It seems that networking is the more critical mode for Malaysian SMEs to discover international market opportunities than does the U-Model. This supports Moha Asri (1999) suggestion that the inter-firms linkages should be described further with regards to the SMEs' international expansion.

Firm-specific Factor

Being aware of opportunities only sparks the interest, it does not assure internationalization as SMEs need strengths within the firm and competent managers to become international players. The respondents stressed the importance of firms having strengths in terms of unique resources, sound finances, skilled and experienced employees, R & D

capability, and information and communication technologies (ICT). This matches previous research that has identified firm-specific factor as being resources that include unique assets, R&D spending, network and reputation (Zahra and George, 2002), advances in ICT (Madsen, Rasmussen and Servais, 2000) and top managers who have international exposure, an international global vision, foreign education and experience (Etemad, 2004). This supports Andersson's (2000) findings that decision to go international "must be wanted and triggered by an entrepreneur who makes key decisions and carries out the internationalization" (p.29). Firm characteristics are important drivers for SMEs to go international so the Finnish-POM Model provides better insights than the U-Model.

Entry Mode and Market Selection

Entry modes include exporting (Leonidou and Katsikeas, 1996), joint ventures (Buckley and Casson, 1996), and wholly owned foreign direct investment, including Greenfield investments and mergers and acquisitions, and leapfrogging (Bjorkman and Forsgren, 2000). Locations and modes can and do differ as many countries, including Malaysia, are restricted by government policy and intervention. In general, Malaysian SMEs do not follow an incrementalist approach to internationalization; they elect to move into neighbors and other countries within the South East Asian region and distant markets as best suits their own needs, or the Governments preferred policies. This suggests the internationalization process more closely follows that of the International New Ventures Theory. Malaysian SMEs use a mixture of modes, which range from exporting to subcontracting, strategic alliances to building up their own facilities and or subsidiaries. This again contradicts the U-Model, lending support to Hommaoudis' (2005) findings that increasing numbers of smaller firms behave differently and do not take the staged approach.

CONCLUSION

In conclusion, gaps remain in the literature on the internationalization of small and medium firms. This study has provided some insights into the internationalization process of SMEs in Malaysia. The behavioral approach that was expected to explain entry mode and market selection was only partly supported. There was little evidence in this study to support the U-Model, as the perception of the experts was that Malaysian firms do not take an incremental staged approach to internationalization. The finding that a firm's choice for going international is related to their internal capability does give credence to the Finnish POM Model as a more appropriate model to explain the internationalization of Malaysian SMEs. The networking model also matches, as the choice to internationalize is influenced by the government and other players, including personal contacts. The surprise finding of the study was that the International New Ventures Model provided a better description of the pattern of internationalization and this warrants further investigation in the follow-up study. The findings provide insights into the entry modes and market selection of Malaysian SMEs that were unexpected and support the need for further research.

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