

Determinants of Internationalization of SMEs using Partial Least Square

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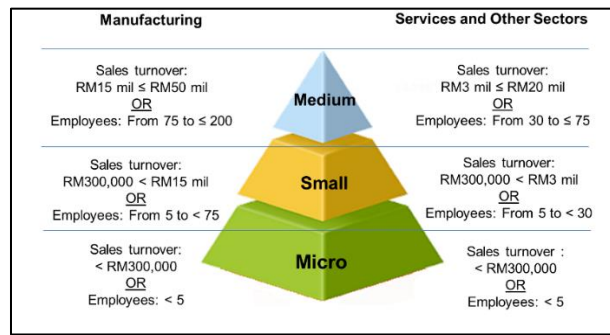
Abstract

Internationalization provides various strategic benefits to the SMEs. It might increase the firm's sales and revenue and be able to sustain in the economy for a longer period. However, the lack of information may become a challenge to the business, thus it is not easy to carry out the internationalization successfully due to limited resources and capabilities. On the other hand, influential factors on SMEs internalization have been discussed in developed countries, yet some developing countries are still struggling for empirical evidence. Some SMEs are facing difficulties in entering the global market as they have zero or less information on it while some of them successfully entered the market and can compete internationally. This indicates that every SMEs has the opportunity to internationalize their goods or services with proper understanding and better information about the global market. Prior studies have been carried out on factors influencing internationalization of SMEs however this study has been done specifically on internationalization of the SMEs in Malaysia. The determinants of internationalization investigated are internal factors, external factors, and networking, using partial least square method. The outcome of this study indicated that external factors, internal factors, and networking do not have any significant relationship with SMEs decision to internationalize.

Keywords: Small Medium Enterprise, Internationalisation, internal factors, external factors networking.

1. INTRODUCTION

Small and Medium-Size Enterprises (SMEs) are one of the major sources of employment, technological advancement, and competitive advantage for both developed and developing countries (Jahanshahi, et al., 2013; Savrul, Incekara, & Sener, 2014). The contributions of Small and Medium Enterprises (SMEs) to the national economy have been acknowledged (Tahir, Mohamad, & Hasan, 2011) throughout the world. SMEs can be found in every sector of the economy as the main drivers for a contemporary economy (Thassanabanjong, Miller, & Marchant, 2009), which bring along development and growth (Grilo & Thurik, 2006).



Sources: SMEs Corporation (2017)

Figure 1: Detailed definition of category, namely micro, small and medium

Sales turnover and number of full-time employees are the two criteria used in determining the definition of SME. For the manufacturing sector, SMEs are defined as firms with sales turnover not exceeding RM50 million OR number of full-time employees not exceeding 200. For services and other sectors

Based on the overview of SME in Malaysia by the Department of Statistics Malaysia, more than 60% of SMEs are mainly concentrated in the top five States namely Selangor (19.8%), Kuala Lumpur (14.7%), Johor (10.8%), Perak (8.3%) and Pulau Pinang (7.4%). Klang Valley (Selangor and Kuala Lumpur) accounted for more than one-third of the total SMEs.

The development of the SME sector is widely seen as a key element of a nation's successful economy (Man, 2009) and a major economic mover. This sector can also be considered a potent source of national, regional, and local economic growth (Taylor & Murphy, 2004; Ramdani, Lorenzo, & Kawalek, 2009). Thus, the development of SMEs is correspondingly recognised as an integral component in achieving sustainable economic growth in Malaysia (Hashim, 2007a). SMEs have always retained prime position on the government's financial radar screen by virtue of their sizeable contribution to the nation's gross domestic product (GDP) (SME Annual Report, 2011), whilst providing job opportunities for over half the population's workforce, and acting as suppliers of goods and services to large organisations (Singh, Garg, & Deshmukh, 2008). SMEs have been identified as the engines of growth (Baharun, Abdul Hamid, & Hashim 2003) to help this nation to become a developed and industrialised nation by the year 2020.

2. LITERATURE REVIEW

Internationalization of small and medium enterprises

Research on internationalization tends to focus on large manufacturing firms (Nik Abdullah and Zain, 2011). Many theories have tried to explain the phenomenon of internationalization through both economic and behavioral approaches. Coviello and McAuley (1999) acknowledge that none of the theories or models can fully capture the actual internationalization of SMEs, which means that an integration of these theories and models is recommended for understanding the process.

To participate effectively in global markets, SMEs are required to have and maintain significant capabilities in different areas ranging over the industry value chain, including production, design, distribution, branding, and marketing (Abonyi, 2003). According to Lages and Montgomery (2004), internationally, SMEs that operate in overseas markets can gain new experience and incorporate this into their local operations, thus leading them to strengthen their competitiveness and global.

Bartlett and Ghoshal (2000) have identified two main motivations for firms' internationalization: traditional motivations and emerging motivations. Among the earliest motivations that drove companies to invest abroad was the need to secure key supplies, especially minerals, energy, and scarce raw material resources. Another strong trigger of internationalization could be described as the market seeking behavior. Bartlett and Ghoshal (2000) further outlined the emerging motivations for firm internationalization. In many cases, the new motivations were driven by a set of

economic, technological, and social developments that made internationalization essential for a company to survive in particular businesses.

The scope for international development is tremendous and encompasses wide areas of international management. Expanding into international markets is often used by firms that seek rapid growth. According to Bradley and O'Reagan (2001), asserted that SMEs should exploit the domestic market opportunities to build up company resources, focusing particularly on developing a high capability, broadly-based management team and an efficient integration of the business system.

External Factors/Environmental factors

The issues such as regulations, the policy, and incentives are also affecting SMEs decision to go international market (Senik et., al, 2014). External factors such as political, economic and social aspect of that country are also parts of the decision to go for internationalization. There are many opportunities for SMEs to internationalize when there is an increase in the economic integration or free trade or when investment increased (Senik et., al, 2014). The external factors that affect the SME's in internationalization can be categorized into the 1) market environment, 2) governmental characteristics and 3) environmental characteristics. The size of market, sales potential, availability and the degree of internationalization in domestic and foreign markets are referring to market environmental (Jones & Coviello 2005; Root 1994). According to Shepherd, Richard and Ronicah (2013), the external factors that affect the internationalization of a firm are regulation, technology and competition.

Internal Factors/Managerial Factors

Internal factor best describes the firm characteristics, competencies, resources, entrepreneurial orientation and key personnel. It was also emphasized that unique resources, sound finance, skilled and experienced employees are the extra point for successful international adjustment (Senik et al., 2014). The key personnel comprise of the personnel experience, attitude, perceptions (Shepherd, Richard and Ronicah, 2013). Senik et al., (2010) emphasized that unique resources, sound finance, skilled and experienced employees are the extra point for success (Barney, 1991 and 2001; Madsen, Ramussen and Servais, 1999). Furthermore, they also mentioned that SMEs owner-top managers need international exposure. This statement was also supported by Etemad (1999) who stated that to go global, the firms must have an international exposure, global vision, experience, and education. Gaining access to the international markets and internationalization is a strategical move for most of the enterprises to help them to be more competitive and allow them for further development. This is because it can help them to identify the potential for the prospective high-growth firm and often a vital move for the SMEs with a large investment. Thus, it supports the resource-based view where they emphasize the main element of internal capability such as firm's unique and internally owned resources are important drivers when achieving competitive advantage (Alvarez and Busenitz, 2001; Barney, 1991; 2001). Senik, Mat Isa, Md Sham & Ayob (2014) stated that the firm resources include the physical organizational, relation and network resources (Calof & Beamish 1995) and to engage in international activities, the firms need to have more resources. (Almeida Sapienza & Michael 2000). Nonetheless, for the SMEs to have a competitive advantage they need to have a unique resource that are uncommon and non-substitutable. Therefore, it is important for their employer to have an international knowledge when they decide to go global. This statement also supports Senik et al., (2014) as they also mentioned that the main key element might include the owner, managers and the decision maker of the firm. An in-depth analysis of the understanding process of SMEs in internationalization could provide valuable information to business communities.

Networking

Internationalization is no longer a reality for large companies only. SMEs are actively inflowing the global competition and internationalizing their operations, which has made operating unconventionally even more challenging. Networks are significant channels through which companies can accomplish their objectives and overcome the restrictions they have by co-operating with others. It is proven that SMEs actively network, then companies have to comprehend how to get the full potential of the relationships in the networks (Leevi, n.d.).

Zain & Ng (2006), Seifriz, Gondim, & Pereira (2014) and others mentioned that social networking has continuously be existent, only the techniques have improved. In this day and age, it can be obviously realized that people network all over the place; the distance between people is less significant than it was only a short time ago due to social and technological advantages. Social interaction and connections between people form the basis of a network and these ties have connected the whole world. Studies have revealed that network relationships have significant influence on SMEs in their internationalization by networks encourage, motivate and provide access to additional channels in the internationalization process.

Studies have found internal and external motivations for SME internationalization. The most important drivers for internationalization are the growth opportunities in other markets and possible increased profit derived from them. Bužavaitė & Korsakienė (2018) point out in their study that SMEs have also knowledge-related motives to internationalize; search of innovation capabilities, unique technology or R&D investments attract SMEs into international markets. If company, on the other hand, possesses critical knowledge and capabilities, it can act as internal motivation. Factors in the external environment of SMEs, such as networks, have been found to motivate the internationalization decisions.

Network relationships have prompted knowledge opportunities for businesses and have motivated firms to enter international markets (Leevi, n.d.). Other researchers claimed that working together collectively can help firms overcome adversity and lack of motivation. Setting up business in international platform have need of a firm to develop a distribution channel to market its products. Developing a network connection with a foreign partner is one of the method to overcome this problem, one with well-established distribution channels (Coviello & Munro, 1995). Besides, network relationships help business people associate to prospective buyers (Kriz & Fang, 2003). In addition, the use of cooperative arrangements by small firms can develop foreign market penetration by providing right of entry to further relationships.

Researchers such as Udani & Chelliah, 2016 have shown that existing network relationships influence the internationalization process of SMEs. These studies found that SMEs follow their networks to close markets. The networks had influence in the choice of target market and entry mode. In contrast, network relationships did not influence SMEs entering distant markets. The choice of target market and the entry mode were strategic. SMEs started to utilize their existing relationships or developed new relationships after they had chosen where to internationalize.

Therefore, research hypotheses were developed.

H0: There is no relationship between the influential factors (external, internal and networking) and SMEs decision to go international.

H1: There is a relationship between external factor and SMEs decision to go international.

H2: There is a relationship between internal factor and SMEs decision to go international.

H3: There is a relationship between networking and SMEs decision to go international.

Theoretical Framework

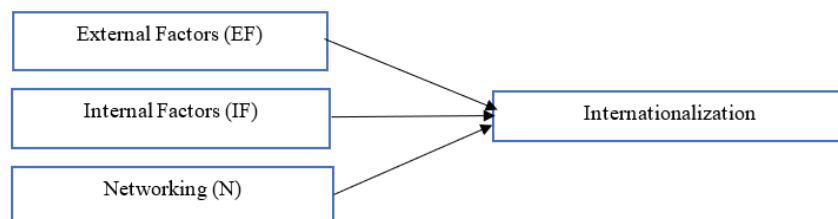


Figure1 Theoretical Framework
Adopted: Senik et al. (2014)

3. METHODOLOGY

The study was conducted among SMEs services companies who registered under MATRADE. There is a total of 300 SMEs services companies under MATRADE databases. Purposive sampling was used to identify the sample, as it obtains information about the companies from MATRADE list. Thus, the target respondents from the population are 105 SMEs services companies which are basically located in Klang Valley. The method used to conduct the survey is by distributing the questionnaire through blast emails to all the companies listed under MATRADE. Partial least square analysis was used to analyze the data to identify the relationship between the influential factors with the decision to internationalization. Furthermore, measurement and structural model applied to measure the validation of items used and the significance relationship of those constructs.

4. FINDINGS AND DISCUSSION

Measurement Model

In PLS measurement model analyzed for convergent and discriminant validity of the items used as in the model. Convergent validity is the degree to which multiple item used to measure the same concept (Ramayah, Yeap, & Ignatius, 2013). The analysis able to assess factor loadings, composite reliability (CR) and average variance extracted (AVE) (Hair et al., 2010). According to Hair et al., (2010), the factor loading should be greater than 0.6, Second, the composite reliability should exceed recommended values of 0.7, while average variance extracted with recommended values is exceed 0.5. If all those values meet, the items used as in survey have high convergent validity.

As depicted in Table 1, the factors loading for 42 items of external factors, internal factors, internalization and networking were greater than 0.6. Consistent with the factor loading values, the composite reliability of external factors (0.937), internal factors (0.924), internalization (0.734) and networking (0.937) result to interpret as high reliability which values exceed 0.7 above. For average variance extracted (AVE), the values for each construct indicates as greater exceed 0.5 values. All the elements of measurement model were meet as in the model and further to analyze on discriminant validity.

Table 1: Measurement Model

Constructs	Items	Factor Loading	Composite Reliability	Average Variance Extracted (AVE)
External Factors	EF1	0.791	0.937	0.602
	EF2	0.808		
	EF3	0.792		
	EF4	0.881		
	EF5	0.822		
	EF6	0.825		
	EF7	0.612		
	EF9	0.561		
	EF10	0.658		
	EF11	0.925		
	Internal Factors	IF1		
IF2		0.785		
IF3		0.751		
IF4		0.76		
IF5		0.738		
IF6		0.909		
IF7		0.679		
IF10		0.649		
IF12		0.471		
IF13		0.666		
IF14		0.6		
IF16	0.737			

Constructs	Items	Factor Loading	Composite Reliability	Average Variance Extracted (AVE)
Internalization	CP1	-0.522	0.734	0.528
	CP2	0.707		
	CP3	0.834		
	CP4	0.774		
	CP5	0.758		
Networking	N1	0.799	0.937	0.599
	N2	0.876		
	N3	0.776		
	N4	0.83		
	N5	0.777		
	N6	0.784		
	N7	0.804		
	N8	0.639		
	N9	0.82		
	N10	0.589		

Discriminant Validity

The purpose of assessing discriminant validity is to ensure that a construct measure is empirically unique and represents phenomena of interest that other measures in a structural equation model is different (Hair et al. 2010). Then test on Fornell Lacker analysis requires each of the construct’s average variance extracted (AVE) must be compared with its squared correlations with other constructs in the model. The cross correlation values of the constructs are not correlate too highly with measures and it is supposed to lower than. As in Table 2, the result showed the cross correlation between construct is lower than and this indicated there was no issue on discriminant validity.

Table 2: Discriminant Validity

Construct	1	2	4	5
External Factors				
Internal Factors	0.874			
Internalization	0.219	0.898		
Networking	0.69	0.219	0.279	1

Structural Model

A structural model purposely to investigate the path coefficient and significance values between the causal relationships. A boot strapping have complete the process of structural model and result as in Table 3. There was only 7.8 percent of the variance present in internalization by external, internal and networking factors. Additional, the external factors ($\beta=0.049$, $t= 0.257$, $p>0.001$), internal factors ($\beta=-0.205$, $t= 0.751$, $p>0.01$) and networking ($\beta=-0.124$, $t= 0.198$, $p>0.001$) had not supported as the t-values was lower than 1.96 and significance value was greater than 0.001. Hence all hypotheses of this study was not supported.

Table 3: Structural Model

Relationship	R ²	R ² Adjusted	Beta Value	SE	T-Values	F ²	Result
External Factors -> Internalization	0.078	0.05	0.049	0.191	0.257	0.001	H1:Not Supported
Internal Factors -> Internalization			-0.205	0.273	0.751	0.009	H2:Not Supported
Networking -> Internalization			-0.124	0.198	0.628	0.005	H3:Not Supported

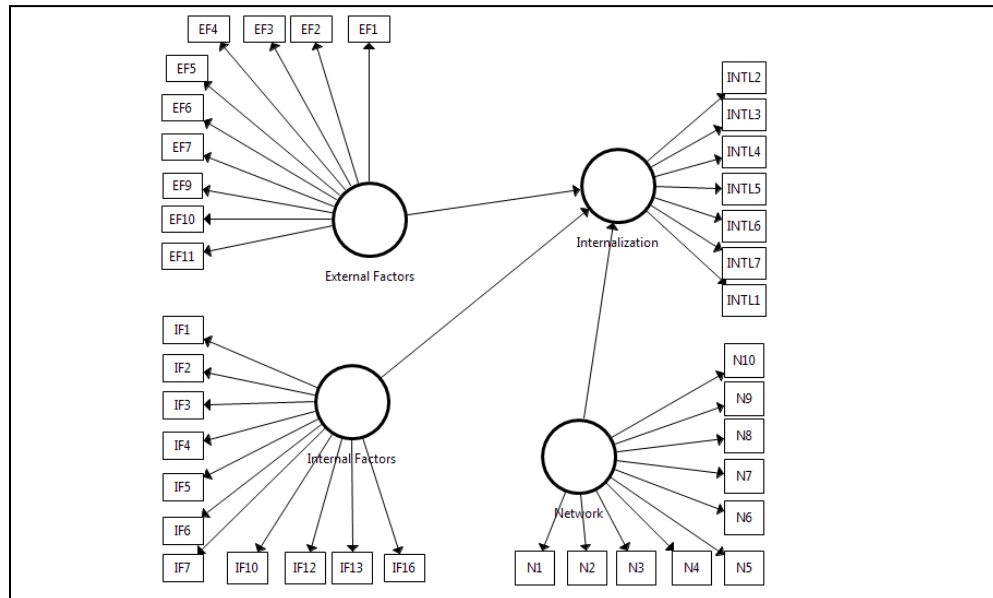


Figure 1. Conceptual Framework

5. DISCUSSION

The study aims to identify the relationship between influential factors and SMEs decision to internationalize. The results show that the external factor, internal factors and networking does not influence the internationalization of SMEs. This result differs from previous studies which Senik et, al (2014) claimed external factor can affect their business when going international and government support on SMEs. On the other hand, the result of internal factors also contradicts with previous studies which claimed that the expert of a firm having strength in terms of its unique resources, sound finances, skilled and experienced employees (Senik et, al., 2010). Mtigwer (2005) claimed that competencies rely heavily on the entrepreneurial planning orientation and the flexibility of top managers' characteristics mentioned by Senik (2014). For networking the result contrast with other studies as the previous result highlight that most of the business strongly believe that better access to international opportunities would come from coordinating and facilitating the network process. Senik et, al (2010) cited in Hashim and Hassan (2008) also mentioned that networking is crucial for Malaysia SMEs to expand into foreign markets. The reliance on the networking factors is also important as proven from the research findings by other countries.

The possibility of this to happen to several SMEs services companies who registered under MATRADE might be due to lack of facilities and guidance from external and internal factors to meet the internationalization conditions. Furthermore, the SMEs also face many difficulties, challenges and issues constraints for them to internationalize. SMEs are uncertain of the risks involved and are less confident of their own capability. They also might lack the knowledge of networking and strategies to expand their business and internationalize.

6. CONCLUSION

Overall, the three variables; external factors, internal factors and networking do not have any relationship with SMEs decision to internationalize. From PLS analysis, it was found that external factors, internal factors and networking factors are not impact drivers that contribute to the SMEs decision to internationalize. As external, internal and networking factors are not significant in the model, this study recommend that SMEs need to investigate the external factors at understanding the demand and needs of consumers, the changes of market, customer preference, law and regulation practices. In review as external factors. They should also play a significant role to disseminate information that help the SMEs in business. For internal factors, the SMEs are recommended to strengthen their unique resources, sound finances, skilled and experienced employees if they would like to decide to internationalize. Finally, in context of networking, the SMEs are recommended to maintain and sustain marketing and planning strategies for the business. The SMEs are also recommended to explore digital marketing which is the trend and is a fast strategy to get directly to suppliers and customers. In recent times, digital marketing has gained more attention among the businesses because it gives a large impact to the business. It is also recommended that the SMEs business to carry out business process re-engineering (BPR) in order to improve on the external factors, internal factors and networking factors so that SMEs are able to internationalize.

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