

THE INTERNATIONALIZATION OF SMALL AND MEDIUM-SIZED ENTERPRISES BASED IN TRANSITION ECONOMIES

MAI THI THANH THAI

Department of International Business, HEC Montréal
3000, chemin de la Côte-Sainte-Catherine
Montréal (Québec), H3T 2A7, Canada

LI CHOY CHONG

University of St. Gallen

ABSTRACT

Current theory has not yet explained the internationalization of small and medium-sized enterprises based in transition economies. Therefore, this study employed Straussian grounded theory to examine how and why these firms internationalize. We found that they internationalize by continuously conducting multiple experiments to find strategies that optimize their chances of meeting the goals of either the firm or its managers while ensuring the best fit with their current environment and quick responses to environment changes. The findings of this research led to the development of a *model of dynamic experimental internationalization*.

RESEARCH MOTIVATION

Our study was motivated by a number of factors. First, our literature review (see table 1 for a summary) reveals that existing theories on the internationalization of firms are unable to explain the internationalization of small and medium-sized enterprises (SMEs) in transition economies, which are characterized by distorted information, weak market structures, poorly specified property rights and institutional uncertainty (Nee, 1992; M. W. Peng & Heath, 1996; M. W. Peng, 2000). Most studies of firm-based internationalization process have focused on firms from developed economies (Canabala & White III, 2008) with a strong bias towards North America, Western Europe, Japan (Werner, 2002). They assume that (1) internationalizing firms have good knowledge of their domestic markets and (2) their internationalization strategy involves exploiting foreign opportunities and overcoming possible liabilities of foreignness by their capacity for using their resources and accumulating international market knowledge (Dunning, 2001; Barney, Wright, & Ketchen, 2001; Mike W. Peng, 2001; Johanson & Vahlne, 2009; Buckley & Casson, 2009; G. R. Benito, Petersen, & Welch, 2009; etc.). Furthermore, Brouthers and Hennart (2007, p. 417) found that “almost all models of international market entry assume that managers are free to choose the most efficient entry mode.” These assumptions do not hold in transition economies, in which the institutional environment changes quickly and frequently, and particularly in those in which information is censored by the government.

On the other hand, the young internationalization literature on firms from transition economies and emerging markets only discusses certain aspects of internationalization rather than the process of internationalization as a whole. It mainly discusses strategies of foreign-invested firms (Filatotchev, Stephan, & Jindra, 2008), organization of joint-ventures in transition economies’ turbulent environment (Mainela & Puhakka, 2009), export orientation of returnee entrepreneurs (Filatotchev, Liu, Buck, & Wright, 2009), factors influencing outward foreign

direct investment (D. W. Yiu, Lau, & Bruton, 2007), drivers of internationalization from developing countries to developed countries (Yamakawa, Peng, & Deeds, 2008).

Therefore, it is necessary to add to current empirical studies on developing countries if we are to acquire a comprehensive understanding of firm-based internationalization. This topic is relevant and timely because the analysis of the institutional variables of developing countries is becoming an important component of our understanding of the globalization of business (Pisani, 2009). By using Straussian grounded-theory method, the present study proposes a model of dynamic experimental internationalization to explain how and why SMEs from such a context internationalize.

Insert Table 1 about here

METHOD

Since there has been little research in this area and the material gleaned from earlier studies is unsatisfactory for the present purposes, the number of relevant categories and variables needed to address our research question about how SMEs in transition economies enter the international market was not known ahead of time. We found that grounded theory method is the most suitable for this study because it allows for the development of conceptual categories and their relationships from raw data (Patton, 2002). Of the two grounded-theory approaches, we consider Straussian grounded theory to be more suitable than Glaserian approach because it permits a preliminary literature review to identify research problems and areas in which to look for data. For this reason, we employed this method for the present research project.

We chose Vietnam as a sampling frame for several reasons. First, Vietnam's economy and Vietnamese SMEs have been internationalizing at a remarkable speed (Kokko & Sjöholm, 2004; UNCTAD, 2006; GSO, 2007). Second, its institutional environment has all the characteristics representative of a transition economy such as distorted information, weak market structures, poorly specified property rights and institutional uncertainty (Nee, 1992; M. W. Peng & Heath, 1996; M. W. Peng, 2000; Vo, 2004; EIU, 2009; Cheng, 2009; ONI, 2007). Third, SMEs account for the vast majority of enterprises participating in import-export activities of this country (ASMED, 2006). And fourth, the principal author of this paper is Vietnamese and has been trained to understand Vietnamese culture. Because she comes from the same cultural context as the respondents, she could help us understand the cultural dynamics behind the respondents' decisions (Peterson, 2004). Also, being able to interview in the language spoken by the interviewees permitted us to limit language biases that can be problematic in cross-cultural interviewing (Marschan-Piekkari & Reis, 2004).

Our research design followed the contemporary guidelines set forth by Straussian theorists. In brief, this mandates a recursive process of data collection, data coding, comparative analysis, and theoretical sampling until theoretical saturation (Glaser & Strauss, 1967; Goulding, 2002; Locke, 1996; Strauss & Corbin, 1998). Because the research process is a process of discovery rather than hypothesis testing (Denscombe 1998), we followed the principles of theoretical sampling as defined by Strauss and Corbin (Strauss and Corbin 1998) and reached the theoretical saturation point after studying 35 cases. It should be noted that all cases were checked against the database provided by the Vietnamese government's Agency for SME Development to

make sure that they qualified as SMEs according to the official definition developed by the Vietnamese government.

EMERGED MODEL OF DYNAMIC EXPERIMENTAL INTERNATIONALIZATION

The findings from our study can be summarized in a theoretical model that is articulated as follows. The presentation of the model follows the format of table 1 so that readers can compare our model with the literature.

I. Theoretical construct: dynamic experiment

II. Explanatory variables:

1. Organizational goals and/or the manager's personal goals
2. The firm's resources and capabilities in terms of decision-making method, organizational technology, and ownership type
3. Perception of whether industry structure & attributes, national business environment, and the country's international economic integration are favorable or unfavorable to their internationalization.

III. Internationalization

1. Motivation to internationalize is determined by the possibility of meeting not just organizational goals *but also* the manager's personal goals. Organizational goals are expected to be a stronger criterion if the managers are also the owners of the firm. Personal goals are expected to be a stronger criterion if the managers are not the owners of the firm, especially in the case of state-owned enterprises whose financial losses are covered by the government.
2. When to internationalize is a question of whether the firm and its managers want to internationalize, whether it has the capacity to do so, and whether it perceives the external environment to facilitate or necessitate internationalization.
3. Internationalization strategy development consists in conducting experiments that the firm can afford and in making the strongest commitment to the strategy that best fits the environment while serving the internationalization objectives set by the firm or the manager.
4. Internationalization pattern is dynamic and contingent upon changes in the context. In other words, if we can predict the type and direction of context changes, we can predict how firms will behave when changes occur.

DISCUSSION AND CONCLUSION

Contribution to the literature

First of all, we found that the unstable institutional environment and corruption in transition economies cause firms to hide their real size and operate as networks of businesses. This finding suggests that sampling for research about characteristics and decisions by top management of firms in this context must be done in a way that eliminates inclusion of firms that are registered in directories as independent firms but in fact are only divisions of another business (i.e. the management of such firms actually resides in another firm). Besides, entrepreneurship studies

should not rely solely on business registration statistics because registration of a new firm may not be an act of new venture creation but merely a paper work procedure.

Second, the model that emerged from our study can be classified as belonging to the behavioral school while including certain elements of the ecological school. Like other theories in the behavioral school, it shares the same assumptions and argues that internationalization is determined by a firm's experience. However, the learning curve does not necessarily result in reduced risk or higher commitment. Rather, the knowledge acquired from concurrent experiments enables a firm to find strategies that allow it to best fit into its environment at a particular time and also have the best chance of meeting the goals of either the firm or its managers. Consistent with a study by Clercq et al. (2005), our paper emphasizes the importance of learning and perception. It goes in line with findings in Mainela and Puhakka's study in Poland (2009) that transition economies present a turbulent context that requires businesses to utilize an effectuation approach (Sarasvathy, 2001; Sarasvathy, 2008). And it supports Ahlstrom and Bruton's findings (2010) that rapid institutional shifts requires firms to rapidly co-evolve with institutional changes in order to survive and to prosper in that environment.

The theory developed from this study stands apart from other internationalization process theories in that it acknowledges the concurrent influence of managerial characteristics, firm characteristics, industry structure and attributes, and socioeconomic infrastructure as well as the interrelationships among these factors rather than considering each factor separately. It clearly demonstrates that the SME internationalization process is not determined by rational choices made with a view to obtaining optimum results. Rather, it is an experimental process undertaken by management which will result in strategies for expansion, contraction or hibernation, depending on contingencies in emerging situations. Unlike existing contingency theories which only account for the potential influence of external factors, our model incorporates both internal and external factors into its explanatory matrix.

Third, our model emphasizes the role of the decision makers and incorporates bounded rationality, decision-making biases, and judgments by managers in the face of environment uncertainty. This element has been neglected in research on managerial decision-making in international business over the past 45 years (Aharonia, Tihanyib, & Connelly, 2010). Our study highlights that firms make decisions based on their perception of external factors but their perception can be far from reality because government censorship can distort the information available to firms. However, as firms continuously experiment and search for information, their perception can change very quickly. This, in effect, can accentuate the dynamism and velocity of strategic changes in the internationalization of SMEs in transition economies.

There are propositions in the literature that internationalization is a value-creation activity and it is led by the entrepreneur (Jones & Coviello, 2005). However, our findings point out that internationalization is not necessarily aimed at creating values for the firm and that it can be a means for decision makers to achieve their personal goals. We also found out that decision makers are not necessarily entrepreneurs, who by definition are risk-takers, opportunity pursuers, and innovators (Fisher & Koch, 2008; Shefsky, 1996). Therefore, internationalization may not be exclusively an international entrepreneurial process since it is influenced by such factors as the firm's internationalization objectives and ownership type (state-own enterprise or otherwise).

Managerial implication

The macro environment of a transition economy requires SMEs to develop the ability to learn quickly through experimentation, to be very flexible to implement strategic and managerial changes quickly, and to solve problems creatively within the limits of their capabilities and resources in order to cope with the ever-changing environment. Therefore, managers of SMEs in transition economies need to stay their course with clearly-defined goals while remaining very flexible in short-term objectives and ways to achieve the goals in the long term. Furthermore, they have to find creative ways of solving all problems arising from contextual changes while accepting the inevitability of external changes and working with limited resources and capabilities.

The results of our study also suggest that if managers in a transition economy can improve the quality of their information acquisition and management, they can conduct better targeted experiments and thus optimize their effectiveness. Foreign companies doing business or planning to do business with SMEs in a transition economy need to be aware that these SMEs are likely to change their strategies. But if they can predict the type and direction of context changes, they can predict how the SMEs will behave when changes occur. In other words, foreign firms can have a significant competitive advantage if they understand the host country environment and are able to use their market and international knowledge, their experience and their relationships to predict changes.

Limitation of the study

Although various measures were used to enhance the robustness of our research, its results are not without limitations. Like other qualitative research studies, it could suffer from problems related to generalizability and parsimony (Ragin, 1994). Our research was not designed to measure across the population, but to develop a theoretical model. Consequently, further research is necessary to test the propositions generated in this study. Another limitation is a possible bias from the retrospective nature of some of the qualitative data, such as the views of interviewees on the reasons for decisions made several years ago. Although the use of multiple data sources and the iterative interview process might minimize this danger, it is nevertheless acknowledged that the possibility of retrospective bias may not have been entirely eliminated. We acknowledge the foregoing limitations. However, since the major goal of our research is to uncover new concepts which can be used to build a theoretical model and to generate a framework for subsequent testing, these limitations do not affect the integrity of our study.

REFERENCES ARE AVAILABLE FROM THE AUTHORS

Table 1: Contributions of the existing literature on firm-based internationalization

Schools of thought	Basic assumptions	Theoretical constructs	Explanatory variables	Decision criteria
Economic school: Internationalization is determined by rational evaluations	-Internationalization is a means to boost the firm's profits and performance - The multinational enterprise is efficient - Decision makers are rational and well-	Transaction costs	Transaction characteristics	Minimization of transaction costs
		Internalization theory	Market imperfections	Exploitation of rent-seeking opportunities
		Eclectic framework	Ownership, location-	Exploitation of competitive

Schools of thought	Basic assumptions	Theoretical constructs	Explanatory variables	Decision criteria
aiming at optimal results for the firm	informed - Firms do thorough market research and scanning to organize their international activities.		specific, and internalization advantages	advantages
		Market-imperfection paradigm	Control	Trade-offs between risk and reward
		Resource-based theory	Firm-specific advantages	Exploitation and development of firm-specific advantages
		Organizational capability	Firm's capability	Trade-offs between value and cost
Behavioral school: Internationalization is determined by the firm's learning curve, which helps reduce risks	- Decision makers and organizations are subject to limited rationality, lack knowledge about alternative actions and their outcomes, conflicting goals and aspirations, and attempts at avoiding uncertainty - Learning curve reduces risks associated with uncertainty	Psychic distance	Cultural distance	Uncertainty avoidance
		Uppsala models	Market knowledge and commitment with regard to psychic distance	Trade-offs between growth and risk
		Innovation-related models	Firm-specific market knowledge and commitment	Trade-offs between growth and risk
Ecological school: Internationalization is determined by external conditions	- The firm is subject to external influences - Foreign market entry modes are different forms of business activity suitable for different types of firms in different circumstances, conditions, and areas of competence	Adaptive models	Adaptability to the environment	Congruence among the structural choices, strategic choices, and human resource choices
		Network-based perspective	Internationalization characteristics of the firm and of the market	Exploitation and development of relationships
		Institutional theory	Institutional constraints	Operationality within institutional constraints
		Evolutionary theory	Environmental changes	Environmental fit