

UNDERSTANDING THE EFFECT OF HOME AND HOST COUNTRY INSTITUTION ON SMEs EXPORT INITIATION

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ABSTRACT

A challenging business environment nowadays made small business especially SMEs think twice before planning to initiate international business. With lack 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 initial stage of SMEs activities in expanding their market internationally. An in-depth interview was conducted with 5 SMEs owner/manager locating in Perak, Malaysia. Basically, this study focused more on home and foreign market institutional environment in determining the success of export initiation among local entrepreneur. Overall, this study finds evidence of the current situation of Malaysia SMEs environment and the challenges that might cause problem to SMEs in export initiation.

Keywords: Home and host country institution environment, export initiation, SMEs

INTRODUCTION

Small business internationalization is an important element of economic development and firm growth. Internationalization is beneficial for economic growth and for country's well being and international reputation. Internationalization is an essential strategic choice for small firm growth (Skrut & 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 & 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.

Additionally, institutions and resource munificence influence SMEs not only directly, but also indirectly via the domestic business ecosystem, which we define as the firms within a given business community and the patterns of competitive and collaborative interaction between them. As the contributions in this special issue highlight, interactions between firms within the business ecosystem of home country shape the strategies of outward investment of SMEs (Hobdari, Gammeltolt, Li & Meyer, 2017).

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).

This study seeks to investigate the significance contribution of home country and host country institution environment in influencing SMEs exporters to initiate for internationalization activity. In next section, the author would like to further deliberate on Malaysia business environment which partly related to home country institution environment.

MALAYSIA BUSINESS ENVIRONMENT

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 Malaysia's SMEs GDP recorded a strong growth at 7.2 percent exceeded Malaysia's GDP which registered at 5.9 percent in 2017 (Department of Statistic Malaysia, 2017). In terms of contribution, the share of SME exports to total export registered 17.3 percent in 2017 (share 2016; 18.6%), whereby most of the contribution account 8.7 percent from the service sector, the second contributor was account for 8.2 percent (manufacturing sector) and 0.4 percent for agriculture sector (Department of Statistic Malaysia, 2017). Meanwhile, 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.

LITERATURE REVIEW

HOME COUNTRY INSTITUTION ENVIRONMENT

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. It is this drive for legitimacy that fosters the processes of internationalization which eventually makes organizations more similar without necessarily making them more efficient, giving rise to institutional isomorphism (DiMaggio & Powell, 1983).

Study by 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; Mezias, 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.

HOST COUNTRY INSTITUTION ENVIRONMENT

While expanding into new geographic markets presents an important opportunity for growth and value creation, the implementation of such a strategy involves many unique challenges in addition to the common ones associated with the domestic growth of SMEs. Many of challenges are typical of the difficulties associated with the liability of foreignness (Hymer, 1976), if the target markets are dissimilar to the original markets and if new subsidiaries are established.

According to Uppsala Model, firms lack knowledge on foreign markets and associate those markets with uncertainty, which cause traditional firms to start expanding into psychically and/or geographically close markets that are somewhat similar to the home market. Because of these firms aversion to risk and lack of knowledge on foreign markets, the firms also start internationalizing by using low-risk and low-commitment entry modes, such as exporting via agents (Olejnik and Swoboda, 2012).

Foreign firms face additional costs, arising from their unfamiliarity with and lack of roots in a foreign environment, what Zaheer (1995) named the 'liability of foreignness' (hereafter LOF). In liability of foreignness, significant differences between markets mean that the knowledge and capabilities that an SME has developed by operating in its original markets are often not suited to operations in the new market. New knowledge and capabilities need to be acquired or developed to successfully enter the new markets. These challenges are compounded when first entering an international market because differences between host and home markets, along political, economic, legal and cultural dimensions, require an internationalizing firm to change many of its ways of doing business that were developed in a domestic-context (McDougall & Oviatt, 1996).

Furthermore, Stepien (2009) argue that the environment of host markets, different from the home market, is more difficult for a multinational entity than for the local enterprises because the latter, embedded in a given environment, perceive its character as given and obvious,

frequently without realizing what kind of specific features it possesses. Entering a host market is linked with a necessity to incur additional costs of recognition and adaptation, including institutional and cultural diversities existing there.

Supported study by Pattnaik and Elango (2006) argue that in the initial phase of internationalization, firms face liability of foreignness, lack economies of scale and bear initial learning costs leading to lower performance. Later, as firms adapt themselves to foreign markets, they are able to exploit their resources effectively, while achieving economic of scale and scope as well as gaining access to lower cost resources and thereby benefiting from increased performance. Finally, as firms extend themselves internationally in many markets, they face extensive coordination pressures due to increasingly complex and dispersed activities, leading to a decline in performance. Some studies find support for the above pattern (Contractor et.al., 2003; Lu and Beamish, 2004), while others find quite opposite results.

In sum, foreign affiliates' performance varies not only between parent firms and between industries, but also between host countries that have different comparative and competitive advantages and provide different institutional environments to foreign affiliates.

METHODOLOGY

The study, aims to gain insight into the effect of liability of foreignness of Malaysian SME on export performance. This preliminary studies represents an intense study of a single unit for the purpose of understanding a larger class of similar cases (Gerring, 2004). The in-depth interviews of 5 SMEs owner or manager which is located in Perak, Malaysia in this context are employed in the studying of the influences of home country institutional pressures and liability of foreignness on SMEs export performance in relation to the Malaysia business environment. The companies were selected using the following criteria:

- Their sized is measured by their number of employees (small and medium firms)
- Their involvement in manufacturing industries in Malaysia; and
- Using export as their medium of operation

The in-depth interviews were therefore selected with owner/ manager of the firms. From the interview, allows the researcher to understand participants' view on the important of home and host country institution environment on their business operation. Semi-structured interviews were conducted on an individual, face-to-face basis. Employing this approach is seen as critical in the sense that it gives a broad picture on the scenario of SMEs exporter challenges in venturing overseas. Furthermore, home and host country institution environment factors as an indicator in determining the success and failure of SMEs export initiation. As not all the respondents were conversant in English, some of the interviews were conducted in Malay language. The questions on implication of home and host country institution environment towards exporting activity were asked among participants.

RESULTS

This paper briefly present in this section pertinent information gleaned the in-depth interviews from the participants.

| Company | Export Destination | Type of product | Home country environment | Host country environment |
|---------|---------------------------|----------------------------|----------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| A | USA | Furniture | a) insufficient export credit financing b) imposed condition that not all can be fulfill c) uncertainty raw material | a) limited export quotas b) labeling of poor quality product from outsider |
| B | Thailand, China | Apparel | a) insufficient export credit financing b) imposed condition that not all can be fulfill | a) seasonal product type b) fabrics quality requirement varies c) price 'edging' d) imitation |
| C | Thailand, China | Seafood | a) insufficient export credit financing b) imposed condition that not all can be fulfill c) uncertainty raw material | a) refusal to accept consignment due to not according to importers quality standard b) high cost of shipment c) exporters have to spend unnecessary port charges |
| D | China, Myanmar, Singapore | Rocksugar, sweetened melon | a) insufficient export credit financing b) imposed condition that not all can be fulfill | a)stringent health regulation imposed b) consistency c) packaging variation |
| E | Taiwan | Plastic | a)insufficient labor supply b)lacking of export funding c)too many documentations d)technology appliances too expensive | a) refusal to accept consignment (due to not according to importers quality standard) |

Table 1 Implication of home and host country institution environment on SME export initiation

DISCUSSIONS

Evidently, this study shows that participants' highlights on insufficient export credit financing and imposed condition that not all can be fulfill as major implication in export initiation. They view that government have already imposed many initiatives to help local entrepreneur but here shows that it still lacking behind. Refers to Saleh and Ndubisi (2006) found that SMEs in Malaysia are facing domestic as one of external challenges which could hinder resilience and competitiveness. They stated that SMEs in Malaysia often face difficulty in obtaining funds from financial institutions and the government with high interest charges. It is proven by manager of company B which claimed that;

'Most of government initiatives do not bring benefit to SMEs that initiate internationalization and of specifically actual needed among SMEs. It's more on political slogan and 'for show' only'

However, it is contrary point of view from business groups that response to SMEs business environment. They commented that most of local entrepreneurs only rely on the subsidies for purpose of survival in today's competitive business world. It also happened that when SME Bank asks for them to join a certain exhibition to promote their products, they will ask for free. Furthermore, in terms of loan application, the firms tend to not complete the applications and also do not even have a proper accounting system to begin with. It is not deniable that most of SMEs do not have proper and manageable accounting system as they involved in 'small businesses'. It is supported by previous studies in regards of export promotion program by home country government.

Government export promotion program are public policy measures offered to business community with the aim to improve the international competitiveness of domestic firms (Lages, Montgomery 2005). The domain of EPPs includes giving export information and advice, marketing support, financial support and guarantees, and promotional activities abroad. The programs are used to help firms develop managers' positive perception toward international operations (Shamsuddoha et al. 2009), reduce mental or actual barriers to exporting (Leonidou 2004), and enhance the capabilities that are crucial to success in foreign markets (Tesfom, Lutz 2008). Developing countries widely adopt export promotion program to enhance exporting activity (Tesfom, Lutz 2008). Empirically, the role of export promotion program has been supported in countries such as Eritrea (Tesfom, Lutz 2008), Bangladesh (Faroque, Takahashi 2015; Shamsuddoha, Ali 2006) and Malaysia (Ayob, Freixanet 2014).

In expanding overseas market, host country (business market) has to take into consideration by all SMEs. As what participants' response to in-depth interviews, there are several constraints occur. It is clearly stated that host country environment are totally different from home country. It is no doubt by entering a host country which is not unfamiliar with will incur additional cost of recognition and adaptation, including institutional cultural diversities existing there. From the interviews result, knowledge on business law and regulation as well as financial practices still major obstacles faces by most local entrepreneur. It happened when SMEs lacking of knowledge about foreign market without doing a research on particular market and do not have wide networking coverage (interpersonal networking). This will cause additional cost to the firm to spend more on adjusting in new market in terms of understanding the cultural and business environment. Besides, discrimination from host country also occurs but not all industries. Finally, like what commented by Company A, furniture industry, he claimed that his product labeled as a poor quality product. It happened in ethnocentric cultural country. This is part of obstacles that local entrepreneur will faced on which is discrimination by foreign market towards foreign products.

From the study, it gives significant contribution to the SMEs owner and government as well. In respect of SMEs owner, this study highlighted the importance of knowing the differences of home and host country environment before get enrolling in international business environment. Furthermore, on behalf of the government, they should impose a training to the new SMEs that start to involve in global market by embedded them in country environment analysis.

CONCLUSIONS

In conclusions, the findings provide evidence that validated earlier studies. Results clearly suggest the important of SMEs especially manager to take into consideration external factors that might cause 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.

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