A DYNAMIC CAPABILITIES PERSPECTIVE OF INTERNATIONALIZATION AND PERFORMANCE OF SMES IN SOUTH ASIA: A CONCEPTUAL FRAMEWORK

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ABSTRACT

As SMEs are internationalizing at a faster rate today, theories that can expound SME internationalization and performance have become extremely important. However, at present there is no agreement among scholars on a single theoretical framework on SME internationalization and performance. Contemporary international market is highly volatile and dynamic hence it is essential for the organizations engaged in international trade to adapt to the environment promptly. In this context, the importance of developing dynamic capabilities to enter and sustain in international market is increasing. This study adopts dynamic capability perspective to analyze success factors of SMEs entering the dynamic international market environment. According to extant literature, SME internationalization and subsequent performance seem to be associated with directly unobservable owner and firm factors which are based on dynamic capabilities. Nevertheless past research does not conclusively prove the complex impact of dynamic capabilities on SME internationalization and performance. To fill this research gap, a conceptual framework that explains the relationship between internationalization and performance based on dynamic capability perspective is developed. Internationalization, entrepreneurship and organizational learning theories have been used to support the dynamic capability platform. The dynamic capabilities in the conceptual framework are market related dynamic capabilities (i.e. brand orientation) and owner specific dynamic capabilities (i.e entrepreneurial orientation, human capital and social capital). This study links industry structure to the propensity of the SME to form dynamic capabilities and the influence of industry structure on internationalization is also further studied. In addition, this framework expands the scope of study in internationalization-performance relationship by considering the moderating effect of organizational learning. This study argues that the subsequent SME performance is moderated by organizational learning, which is a vital source of dynamic capabilities.

Keywords: Dynamic capabilities, Entrepreneurship orientation, Brand orientation, SME, Internationalization, Organizational learning

1. INTRODUCTION

1.1 Contribution of SMEs to economic and social growth

Small and Medium-sized Enterprises (SMEs) make up over 90% of businesses worldwide and 50 to 60% of global employment (OECD, 2004). SMEs enhance economic growth in market driven economies (Beck, Demirguc-Kunt & Levine, 2005). Especially, SMEs make noteworthy contribution to the economic growth of developing countries (Afsharghasemi, Zain, Sambasivan, & Ng Siew Imm, 2013). In general, contribution of SMEs to economic value varies from 16% of GDP from low-income countries to 51% of GDP in high-income countries (D’Imperio, 2012). Researchers have revealed that the prospects of future economic development of the South Asian countries depend on improvement to SME sector (Amaratunge, 2003). According to Vijaykumar (2013a) there is a positive relationship between economic growth and SMEs. They provide emerging economies some relief from the vicious circle of poverty (Dasanayaka and Sardana, 2011).
SMEs play a key role in social development of a country. Due to lack of resources to achieve economies of scale advantage or differentiation through market management, SMEs mainly achieve differentiation through innovation (Svetličič, Jaklič, & Burger, 2007). Therefore SMEs are also considered as vehicles for innovation and technology dissemination (Piech, 2004). SMEs play significant role in generating employment. It is believed that poverty alleviation can be partly achieved through more employment generation (Vijayakumar, 2013b) and the SMEs play significant role in generating employment as per Birch (as cited in Parker, 2012). SMEs are an opportunity to improve employment of women and a solution to gradually increasing old age population who are looking for work (Paunovi & Prebe, 2010). SMEs can be used to initiate a sectorial restructure of the goods and services within an economy, which is a dire need of South Asian countries with the stagnation of the industry structure within a few number of low value added products (South Asia Economic Summit Proceedings, 2013). SMEs can be exploited to geographically diversify, industries which are heavily concentrated in urban areas to solve another common issue in South Asian region (Nishantha, 2010).

1.2 Critical issues faced by SMEs

SMEs in South Asia have shown some unusual characteristics. A majority of SMEs belong to non-formal sector and report low productivity (Dassanayaka, 2008). SMEs in South Asian region are struggling with cheap imports from other countries and demand the government to tighten regulations presumably to protect from high cost arising out of lack of efficiency management (Dassanayaka, 2008).

Shane (2008) stated that after ten years of establishment small venture failure rates have been found to be up to 70 percent. Gunarathne, (2008) emphasized that a majority of small businesses have moderate to low growth ambitions and hence only a small proportion of businesses was capable to achieve employment growth. Further, World Bank highlighted that within 8 years of receiving a Small and Medium Investment (SMI) loan to SMEs in Sri Lanka, only 20 percent of the SMEs survived (Task Force, 2002). Moreover, according to Ropega (2011) only about 50 percent of small businesses are still trading after the first three years from inception. Despite the intervention of governments, SMEs of South Asian region have not shown any improvement in their sustainability and performance indicators of

South Asian SMEs remain lower compared to other regions (Wijesinghe, Elijiido-ten, & Foreman, 2012). High failure rates and the stagnating behavior of the majority of the SMEs limit the ability of generating employment and participation in economic growth all over the world.

The low level of technology, lack of technological applications and absence of technical and management skills have also been identified as important constraints that affect the SMEs’ ability to face stiff competition from local and foreign products/services (Dassanayaka and Sardana, 2011).

The definition of SMEs eludes a widely accepted definition. Not only different countries apply different definitions in defining SMEs, even within countries, different institutions adopt varying definitions (Gamage, 2003). McAuley (2010) studied definitions of SMEs in past internationalization research and found large difference in definition of SMEs. The considerable alert of this finding is on the comparability of SME research. The basis on which SMEs are defined reflects the stage of economic development of the country and the policy purposes for which the definition is used (Wickremasinghe, 2011). Larger and wealthier the economy, the definition of SMEs tend include more number of employees (Gibson, 2008). Some researchers hold the view that country differences are so large that it cannot be assumed to draw the SMEs from one population.

Compared to other regions the contribution of SMEs to overall GDP is very low in South Asian region. However, due to absence of universally agreed definition, the comparability of the figures is low. This decrease in overall contribution to GDP signals that the governments have not been able to realize the potential to increase domestic industry growth, and yet to strengthen the backbone of the economy in an escalating global economic rivalry.

1.3 The impact of internationalization to SME sector

World trade is growing fast and, opening up multitude of opportunities for SME sector to capitalize on (WTO, 2014). Opportunities which are opening up through growth in communication and information technologies, trade liberalization, government support and demand in developed countries provide
platform for SMEs to expand their local operations (Rialp, Rialp, & Knight, 2005).

The benefit of internationalized SMEs can be studied at macro-economic level. According to Filippetti, Frenz, and Letto-gillies (2013), the internationalization degree of a country increased innovation performance of 42 countries. As per Hessels and Stel (2009), export oriented entrepreneurship behavior affects the macro economic growth in high income countries. At a macro level, internationalization creates a more favorable Balance of Payment (BOP) value, helps industries to improve productivity, supports socio-economic development as a whole, and increases employment opportunities (Aissa, 2009).

Past research conclusively prove that internationalization provides a multitude of benefits for SMEs including better survival prospects (Lee et al., 2012), increased revenue and growth (USITC, 2010), better innovative capability (Kalnic & Forza, 2012) and improved productivity (Achtenhagen, 2011) compared to non-internationalized SMEs. From a theoretical perspective, the above benefits were explained using transaction cost theory, resource-based view, organizational learning theories etc. Governments all through out the world have introduced incentives, and opportunity to participate in government schemes to provide support and encourage SME internationalization hoping that the SMEs and the country will reap the benefits in the long run. (Hashim, 2012; Solomon, Bryant, May, & Perry, 2013)

Regardless of an increasingly favorable macro environment for international trade, frequently highlighted benefits of internationalization to the firm, and increased government support, the level of internationalization and interest on internationalization remains unusually low for SMEs. In direct contrast to the expectation, SMEs still contribute only about 25% of the global export income and less than 10% of global Foreign Direct Investment (FDI) (Hall, 2012). Since SMEs make up more than 95% of the market participants, it is obvious that their contribution to value addition in international market is disproportionately low (OECD, 2004). According to a report by COMCEC (2013), SMEs are under-represented in international economy across countries of development implying a highly skewed nature of the export structure.

SMEs all over the world are internationalizing at a faster rate today and therefore the theories that can explain and guide internationalization are of extreme importance than ever before (Schulz, Borghoff, & Kraus, 2009). Coviello, McDougall, & Oviatt (2011), clearly mentioned in their review article that internationalization theories should be supported with “multi-theoretical perspectives”. Autio (2005) called for an “integrated explanation” and Mathews and Zander (2007) called for “careful consideration of existing theories and variables and integrate them”

Referring to a review article of Aspelund, Madsen, & Moen (2007) which analyzes thirty articles published in academic journals from 1992-2004, it contains only one study from Asian context. All the others were of non-Asian origin. Literature review reveals that entrepreneurial orientation and internationalization relationship in South Asian context was published in just one reputed academic journal. According to a review article on international entrepreneurship by Kiss, Danis, & Cavusgil (2012), out of 51 articles carried out in emerging economies over a period of decade, one article was published in reputed entrepreneurship and international business journals in South Asian context. The least frequently studied region of the world has been the Middle East Africa, South Asia, and Latin America and the Caribbean. Lack of empirical studies in developing countries during the last two decades places the applicability of the findings of internationalization studies to developing countries in question (George & Zahra, 2002).

Inadequacy of research on internationalization of SME studies calls for more empirical information (Andersson, Evers, & Kuivalainen, 2014; Aspelund, 2007). Too small sample sizes (Chiao, Yang, & Yu, 2006), lack of and difficulties in obtaining accurate data, research focus on specific industries (George & Zahra, 2002; McAuley, 2010), lack of empirical data on developing countries (Banalieva & Sarathy, 2011) and contradictory research outcomes add to the issue of lack of research.

South Asian SMEs have extremely low rate of internationalization and low contribution to exports which is below the global average. (e.g. Sri Lanka – 5%, Pakistan – 25%). SMEs are over-reliant on low cost advantage and tariff concessions, both of which are dwindling in the contemporary international business (Wijesinghe, 2010). SME exports in South
Asian region are highly concentrated and stagnant on limited number of traditional products and destinations.

Stepping into internationalization can be very risky task given the resource poverty condition of SMEs. Unfortunately, many of the developing countries have not strengthened their SMEs to get in to the fray and therefore lagging behind in value additions to the economy yet. Most SMEs face either perceived or actual barriers in stepping into the international market. According to Kumar (2012) SMEs confront with the threat of international competition, networking issues, policy and regulation matters, financial constraints etc. when attempting to internationalize or after internationalizing. Based on a result on SMEs in USA, the researchers identified insufficient intellectual property protection, taxation, financing, inability to locate foreign partners, and difficulty in getting payments as major barriers for internationalization (USITU, 2010). OECD (2004) identified the most common barriers to internationalization as access to finance, identifying international business opportunities and limited information on markets. Given the diverse nature of economic, regulatory and financial systems of different countries, several other scholars have identified country specific barriers in a number of studies. In conclusion, Leonidou (2004) states that “two firms at the same stage of export will not necessarily perceive same obstacles” highlighting that it is difficult to generalize barriers to SME internationalization under one umbrella.

A comparative study of Norway and Lithuania revealed how differences in country context affect the perceived barriers to internationalize. Lithuanian SMEs selected market information and bureaucracy as top barriers whereas Norwegian respondents indicated bureaucracy and intense competition as top barriers (Korsakienė & Tvaronavičienė, 2012). South Asian governments have been trying to minimize internationalization barriers through focused programs and incentive schemes. Although such narrowly focused programs make sense in countries where macro-economic variables are conducive for business, in developing countries SMEs expect the government support in more macroeconomic aspects such as taxation, legislation, interest rates, curb corruption etc. (Shirokova & Tsukanava, 2013). This posits that if the barriers faced by developing countries and developed countries are found to be substantially different, then it raises concerns about the applicability of western originated research models in South Asian context because the factors that affect internationalization could be different (Gaur & Kumar, 2009)

There is a large emergence in entrepreneurial activities in many South Asian countries with their impressive growth rate. This research will be timely contribution in developing a regional model of internationalization to foster their quest in stepping in to international market.

2. LITERATURE REVIEW

2.1 Relevance of Dynamic capabilities theory to internationalization

The dynamic capabilities model proposed by Teece, Pisano and Shuen (1997), is extensively considered to investigate the firm performance. However, this theoretical model is rarely used in SME internationalization (Evers, 2011; Kuuluvainen, 2012; Coombs & Teks, 2009). This study uses the dynamic capabilities theory to integrate a diverse set of owner specific and firm specific factors under one grand theory to explain SME internationalization which is lacking a coherent theoretical explanation (Schulz et al., 2009).

Dynamic capability theory posits that if marketplaces are dynamic rather than simple heterogeneity in firm resource endowments it is the capabilities by which firms’ resources are acquired and deployed in ways that match the market environment that explains inter-firm performance variance over time (Morgan, Vorchio & Mason, 2009). Although many scholars identify the importance of dynamic capabilities, a main criticism on dynamic capabilities perspective is that it is very difficult to operationalize. Even the existing operationalization have been criticized of being too vague and incomplete (Arend & Bromiley, 2009). Hence, most past researchers have tested the existence of dynamic capabilities through existence of other characteristics such as entrepreneurship, networking, leadership, market orientation etc. The dynamic capabilities are actually manifested in other characteristics of a firm, but in an implicit manner. The study would narrow down its theoretical scope of the dynamic capability based view to study the role of decision making by owner/top managers.
Research on dynamic capabilities and internationalization has not been linked with appropriate empirical evidence although export markets have been described as being highly competitive and therefore dynamic (Prasertsakul, 2013). Sapienza, Autio, George, and Zahra (2006) argue that SMEs need dynamic capabilities that allow them to survive and reap the benefit of their innovation. Luo (2000) argue that dynamic capabilities are a necessary for the existence of a firm under very dynamic international business conditions. Though there is a rise in research interest in dynamic capabilities in international business context, empirical studies are rare, and often mainly focus on MNC. Study by Sternad and Jaeger (2013) highlights the key role of SME managers in the export performance of SME through enabling the improvement of export-related dynamic capabilities. They find that export related dynamic capabilities can substitute for deficiency of other resources. The importance of dynamic capabilities become profound in international economy with the opening of the economy of many countries, and as the competitors become diverse, high in number and flexible (Teece, 2000). Theoretical and practical importance of developing and applying dynamic capabilities to sustain competitive advantage in complex and volatile external environments has become a critical research issue of many scholars (Zahra, Sapienza and Davidsson, 2006).

Though internationalization of SMEs has been explained using entrepreneurship approach (i.e. considering the internationalization as an entrepreneurial behavior), transactional cost approach (i.e. considering the internationalization as an economic opportunity to be exploited) and organizational learning approach (i.e. the SMEs learn and gradually expand into the international market), little success has been reported in fully explaining this complex phenomenon. All the above theories have not considered the ever increasing dynamism of the international business environment and have been used separately and in isolation to explain the phenomenon. This leads us to search for the applicability of a grand theory to integrate the above theories under one grand theory. This research builds on the foundations of theory of dynamic capabilities proposed by Teece et al. (1997). Schweizer, Vahlne, and Johanson (2010), endorse that dynamic capabilities perspective is relevant to explain internationalization. They state that “dynamic capability perspective adds a new dimension to the internationalization literature”. They argue that internationalization of firm may be due to sticky resources and conversely firms may not internationalize as a result of sticky resources. Teece (2006) compares Hymer to more recent dynamic capabilities-based contributions and claims that dynamic capabilities approach can improve upon Hymer’s earlier, rather static, analysis of internationalization. In a case study, Kuuluvainen (2012) argued that dynamic capabilities are important determinant of internationalization success.

2.2 Entrepreneurship theory

Internationalization and entrepreneurship was considered to be separate paths with no interconnection until the work of Oviatt and McDougall in 1994. The origin of International Entrepreneurship (IE) runs back to the empirical study comparing domestic and international new ventures in 1989 by McDougall (Oviatt & McDougall, 2005). IE was defined as “combination of innovative, proactive and risk seeking behavior that crosses national borders and is intended to create value in organizations”.

At present, technology advancement and resource scarcity directly threaten stability and prediction of business environment. SMEs must adopt entrepreneurial strategies to seek opportunities and integrate resources in order to obtain competitive advantages. Internationalization of enterprises can be seen as entrepreneurial behaviors of firms in the global market. Entrepreneurial behavior is based on highly focused recognition, discovery, and opportunities seeking which are also the key foundations of dynamic capabilities.

Entrepreneurship has been identified as very critical ingredient of dynamic capabilities. Both theories actually posit the importance and receptivity to change. Pro-activeness and risk taking dimensions bring fit with the external environment rapidly. Pro-activeness helps to identify market changes while risk taking dimension helps to take the bold steps based on the information. This is in line with the opportunity sensing and seizing capabilities proposed by Teece (2007) as major foundations of dynamic capabilities.
Innovativeness helps the SME to develop new products and processes and enter new markets which will in turn help the SME to learn and generate new ideas. These new perspectives will lead to dynamic capabilities through positional advantages.

2.3 Organizational Learning

Organizational learning is a principal source of dynamic capabilities (Helfat et al., 2007; Barrales-Molina, Benitez-Amado, & Perez-Arostegui, 2010). In international business, especially because it is operating in a highly dynamic marketing environment and because knowledge of market preferences reduces the degree of incompatibility of new products with customer needs, organizational learning is likely to enhance the adoption and success of international offerings. According to a report by OECD in 2006, suggests that SMEs undergo a learning process as they internationalize. Learning oriented firms are quick to exploit international opportunities and develop innovative product, processes and models (Wickremesooriya, 2011). Organizational learning theory was used to explain and justify incremental internationalization with its pillar on gradualist models of internationalization (De Clercq, Sapienza, Yavuz, & Zhou, 2012).

2.4 Eclectic theory

A recent article by Al-Aali & Teece (2013), suggests incorporating entrepreneurship and dynamic capabilities into the Dunning eclectic theory. They build on the article of McDougall and Oviatt (1994) which identifies necessary element for rapid and sustainable internationalization as internalization, alternative governance structures, location advantage, and unique resources. Accordingly, internalization can occur by two motives, i.e to reduce transaction cost and/or to receive benefits of learning. As per the location, the argument is that many typical location-related advantages, such as low-cost labor, can also be accessed by competitors with relative ease. Hence these are ordinary capabilities which do not give a sustainable advantage. Similarly, it is not the ownership of assets that is important; it is how effectively the assets are used (asset orchestration).

Eclectic theory is still valid as a theoretical model to explain internationalization, but emphasis is placed on dynamism of the organization for sustainable international presence.

2.5 Internationalization theories

Early internationalization theories were based on the economic rationale (i.e Hymer’s Industrial Organization theory and Dunning’s Eclectic theory). However, Johanson & Vahlne (1977) explained that firms internationalize according to a chain of establishment which became known as the Uppsala model of internationalization. Firms are assumed to enter markets with least psychic distance initially. The concept of psychic distance is based on the individual’s perceived difference between home and foreign country (Abdualla & Zain, 2011). Uppsala assumes that firms origin with limited or no knowledge of foreign markets and therefore is a major constraints in internationalization. However, in today’s world of information and communication technology such an assumption seems to be unrealistic where market information and opportunity to form networks at low cost is abundant. While this gradual step wise approach to international market may make sense in mature, low volatile, static and uncompetitive markets, for many businesses, the nature of the global business environment does not warrant such a gradual approach. However, the assumption that learning helps to overcome the limited knowledge of foreign market is not unrealistic. Uppsala model, though confronted with contradictory findings (Forsgren & Hagström, 2007), is still respected as the major milestone in internationalization theory development due to its simplicity, generalizability and as the pioneering work that paved way for many constructive arguments among the scholars.

Johanson and Mattsson (1988) proposed a network perspective to the gradualist model. Their explanation was that internationalization of organizations cannot be studied in isolation and has to be analyzed in its environment of networks. This was partially helpful in explaining the rapid and non-graduate internationalization of SMEs as the unit of analysis was changed from “isolated firm” to a part of value chain and the reliance of psychic distance and experience based learning in explaining internationalization could be relaxed. Johanson and Vahline (1990) clarified network factors in the internationalization model. Accordingly contemporary market (against neo-classical market) is a network of relationship and the firms are linked in complex and invisible pattern in this network. Insidership in this network is a necessary condition for
internationalization. The company has to be analyzed considering that it is part of this broader network.

Recently many scholars argue that internationalization is associated with and explainable with entrepreneurship theories and related the phenomenon of International New Ventures (INV) to entrepreneurship (George & Zahra, 2002; Lu & Beamish, 2001; Oviatt & McDougall, 1994).

2.6 SME performance

Although the transaction cost theory implies a positive relationship, the empirical results on internationalization-performance relationship have been described as heterogeneous, unconvincing and contradictory (Aulakh, 2009; Baldegger & Schueffel, 2008). The reported outcomes ranged from positive linear (Annavarjula et al., 2005), negative linear (Michel and Shaked, 1986), no significant relationship (Dunning, 1985), U-Curve (Lu and Beamish, 2001; Ruigrok & Wagner, 2003a), inverted U (Li & Qian, 2005) and more. In a review Hennart (2007) questions the rational of expecting a link in the first place pointing that there is no theoretical support to expect a relationship between the variables. Hennart (2007) argues that because firms tend to invest in least physic distance countries and exhibit little product diversification, a substantial reduction in systematic risk cannot be expected. Secondly, he argues that economies of scale have little relevance to whether the increase in scale comes from outside country or inside. Thirdly, he argues that firms cannot shift activities to other locations at a flexibility cited mainly due to fixed costs and because new networks take time to build. Learning effect mentioned in the TCT is also questionable as most firms go abroad to exploit the resources rather than explore which adds values to the knowledge stock of the organization (Hennart, 2007)

A majority of scholars are however not as unenthusiastic as Hennart (2007). According to some scholars internationalization benefits has a critical threshold (Heyder, Makus, & Theuvsen, 2011). Contractor (2007) adopts a three stage theory of internationalization in which the first and third stage brings more incremental costs than advantages from internationalization. Accordingly all U shaped, linear and inverted U shaped relationships are parts of a single graph which spans through the three stages.

The personalized management style means that SME objectives are highly influenced by the owner/manager vision and philosophy. Therefore the non-financial factors such as social prestige of managing an own company, providing jobs to relations and friends, personal freedom become equally important as financial performance. With less number of customers, customer satisfaction and with greater roles and responsibility of employees, employee satisfaction becomes important performance indicators for SMEs (Hudson et al., 2001; Richard & Johnson, 2009). Performance measurement criteria especially in SMEs is also influenced by factors such as ownership, size etc. It was revealed by Basly (2007) that family businesses tend to remain small due to owner’s preference for more control. In such cases using a single financial indicator such as SME growth or sales growth would be misleading. In other words, what is meant by “performance” in SME context may not be the same as in large firms. Newby (2007) argued that performance may have a different set of meanings for small firms than for large firms and “profits and business growth, while important, were less substantial measures of their success.” Strong profitability may or may not be an important objective for a new venture, which is trying to establish a grip in a market (McDougall & Oviatt, 1996). Confronted with great uncertainty, INVs focus on establishing a market position, reaching potential customers, educating them and developing relationships, which consume resources thereby decreasing profitability. However they are critical to sustainability and survival (Mudambi & Zahra, 2007). Therefore it is recommended to include non-financial dimensions to measure SME performance (Hughes and Morgan, 2007) and measure performance in a multi-dimensional perspective. This theoretical underpinning leads us to the development of following hypothesis

\[ H1 – \text{Internationalization significantly influence SME financial and non-financial performance} \]

2.7 Owner specific Dynamic Capabilities

2.7.1 Relevance of EO (Entrepreneurial Orientation), SC (Social capital), HC (Human Capital) to internationalization

To understand the empirical issues, past research studied SME internationalization with EO (Entrepreneurial Orientation), SC (Social capital), HC
(Human Capital), Industry and performance with theoretical support. However, a long standing inconsistent relationship among these variables and internationalization are observed.

According to international entrepreneurship theory it is rational to state that EO could be a valid predictor of internationalization of SMEs (George and Zahra, 2002). Strangely, the effect of EO on firm internationalization has proved fairly inconsistent. (e.g. Zhang, Ma & Wang, 2012; Javalgi & Todd, 2011; Johan & Svante, 2011; Frishammar & Andersson, 2008)

Social capital is defined as “naturally occurring relationships to promote or aid the development of valued skills or characteristics” (Loury as cited in Bosma et al., 2000). Empirical evidence on the effect of networks on internationalization is scarce (Ciravegna, Lopez & Kundu, 2013). According to research by Colovic and Lamotte (2014), networks are more important for SMEs in internationalization as they have little resources and they also act as a substitute for less internationally experienced entrepreneurs. An effective way for SMEs to develop international markets is to acquire reliable access to resources through business networks, rather than trying to secure resources through internalization (Oviatt & McDougall, 1994). For SMEs, the lack of resources and capabilities means they face higher transaction costs and risks in the marketplace, which in turn impedes their internationalization efforts. Rather, their primary competitive advantage rests in exploiting networks of external relationships (Mathews & Zander, 2007), and their internationalization efforts can be viewed as a process of developing and accessing social capital as they establish and deepen network relationships (Johanson & Vahlne, 2009).

Social networks are an efficient means of helping internationally oriented SMEs to go international more rapidly due to three information benefits: (1) knowledge of foreign market opportunities, (2) experiential learning, and (3) referral trust. A review of past studies highlight the effect of networking on internationalization has been mixed. (e.g. Loane & Bell, 2006; Fernhaber & Li, 2012; Ciravegna, Lopez & Kundu, 2013, Lin & Chaney, 2007, Rodrigues & Child, 2012)

Human capital consists of knowledge, skills, talent and experience used to provide value to the firm (Fletcher, 2004). As per surveys carried out by OECD and Asian Pacific Economic Cooperation (APEC), both policy makers and SMEs rated internal capabilities and resources as their main barriers to internationalize. According to De Clercq et al. (2012), the individual knowledge can act as a substitute for organizational knowledge in the learning curve in internationalization. According to Kamakura, Ramón-Jerónimo and Vecino Gravel (2011), human capital, technology, and managerial ties overseas appear as key factors in the internationalization process. Researchers confirm the positive effect of education and international experience on firm internationalization (e.g., Herrmann and Datta, 2005).

The main dimensions of HC used by past researchers in SME internationalization studies are age, education, work experience, ability to speak foreign languages (Small & Growth, 2010). According to a research by Fernández-Ortiz & Lombardo (2009), top management human capital influences international diversification of SMEs. International exposure and networks were found to have a substitute effect on ability to internationalize (Fernhaber & Li, 2013). According to Javalgi and Todd (2011), human capital (i.e education and experience) have a major impact on internationalization.

Recent research on SME internationalization places more weight on the attributes of key management personnel. According to Hsu, Chen, & Cheng (2013), CEO attribute such as age, experience and education level play a moderating role in the much arguable internationalization-performance relationship. He argues that since expanding into international business is a complex task, managers attempt to “reduce cognitive effort using heuristics and cognitive schemas to integrate pieces of information into a single judgment”, which is largely influenced by entrepreneur human capital. However according to Manolova, Brush, Edelman, & Greene, (2002), traditional demographic human capital factors do not distinguish internationalized SMEs from non-internationalized SMEs. On the contrary, higher levels of education, maturity and experience of the owner, especially on the international stage, tend to promote the development of strategies or action plans able to support the international activity (Mason, 2009). Past researchers have stated existence of different kinds of
relationships between age of the owner and internationalization propensity and development. (e.g. negative relationship as per Karami (2005) a positive relationship as per Ursic and Czinkota (1989) and no relationship as per Karami, Analoui, and Kakabadse (2006). As illustrated by recent examination of internationalization literature, it fails to confirm a direct causal link between human capital and firm internationalization.

2.7.2 EO, HC and SC as dynamic capabilities

This research posits that EO, HC or SC of entrepreneur are only elements of Dynamic Capabilities (DCs) required for internationalization as stated by past scholars (Zahra, Sapienza & Davidson, 2006; Teece, 2007; Castanias & Helfat, 2001; Fernhaber & Li, 2013). Wang and Ahmed (2007) address on common features pertinent to dynamic capabilities that are applied to describe by adaptive capability, absorptive capability, and innovative capability. Adaptive capability is a firm’s ability to identify and capitalize on emerging market opportunities and also to perceive, explain and react to market changes. This is similar to pro-activeness dimension of EO. Absorptive capability is a firm’s ability to identify, recognize the value of external knowledge and utilize or apply it for internal use to commercial success (Cohen and Levinthal, 1990). It is depended on experience of the entrepreneur; a dimension of HC. Innovative capability is firm’s ability to develop or create new products and/or markets also apply technologies to develop to firm process which is depicted in innovativeness dimension of EO.

According to Rothaermel & Hess (2007), the dynamic capabilities development actually takes place in many levels such as individual, firm and external level. They identify the interplay between the different levels when they conclude that individual human capital substitute the firm level R&D capability.

Adner and Helfat (2003) introduced a concept called dynamic managerial capabilities which are a sub-element of general dynamic capabilities. Accordingly human capital (Castanias and Helfat, 2001), social capital and managerial cognition (Barrales-Molina, Benitez-Amado, & Perez-Arostegui, 2010) are instrumental in developing dynamic capabilities.

In a conceptual paper focused on entrepreneurial firms, Weerawardena et al. (2007) explained a model to understand the development of a ‘strategic set of dynamic capabilities’ as an important requirement for internationalization. They differentiated between networking capabilities and learning as the main second-order competences which enable a small firm to create the knowledge-intensive products which they can then offer on international markets.

2.7.3 Complex interplay between EO, HC and SC

To develop DCs, entrepreneur needs to secure all EO, SC and HC dimensions as they play a complementary role (Weerawardena et al., 2007). Although taken separately none of these offer a comprehensive explanation of ability to internationalize, taken together as a composite variable they should do so. This research argue that a new second order formative composite construct which we named as “owner dynamic capabilities” will capture the complex interplay between EO, HC and SC of the entrepreneur. The effect of each of the above variables has been tested in SME internationalization literature but none of them have attempted to identify the link and the synergic effect of them. For example, Ruzzier, Hisrich, & Antoncic (2006), proposed a conceptual framework which linked entrepreneur human and social capital to SME internationalization. However, this article did not provide an acceptable underpinning reason to link those factors. The link between the three variables have been well established in following research articles.

Following work started by Cohen and Levinthal (1990), a number of scholars have found that a firm’s ability to recognize and acquire new information is dependent on their absorptive capacity, or the prior knowledge and experience of entrepreneur. Ability to recognize and acquire new information is embedded in the dimensions of proactiveness in EO. This posits that a close link between EO and HC exists.

Physiological decision was found to decrease significantly after the first or second international market entry implying the importance of international exposure of managers prior to internationalization. (Dow, 2000). This means that when HC is present, the risk taking dimension takes less prominence again implying a close link between EO and HC.
According to Kusumawardhani, McCarthy, and Perera (2009), EO is not sufficient to enter international markets for SMEs in developing countries where they rely a great deal on networks.

Risk taking dimension of EO is defined as a willingness to commit significant resources to opportunities that have a “reasonable chance of failure” (Lumpkin and Dess, 1996). The term “reasonable chance of failure” needs further discussion. The question is what facilitates entrepreneurs to identify ventures of “reasonable chance of failure”? This research builds on the argument that existing scales to measure EO alone do not capture this criterion fully. This research argues that the entrepreneur education, experience and networks actually act as precedence to help the entrepreneur to identify such ventures in international expansion and evaluate the riskiness. Hence, this research develops a composite scale of entrepreneur orientation, social capital and human capital to arrive at a more appropriate variable related to internationalization.

In an article that explores how market knowledge develops over time in INVs, Hanell et al. (2014) finds out that impact of EO of the entrepreneur changes during internationalization process. As high EO cannot guide INV in the later stages of development, the firms rely more on learned lessons become less entrepreneurial. However entrepreneur experience is crucial for the firm’s initial international development (Andersson, 2011). This further strengthens the argument of this research that a composite of the variables that were previously tested in isolation actually gives the dynamic posture to the SME.

Social capital theory posits that the extent and effectiveness of social and community relations modifies returns to human capital (Coleman 1990). Hence, social networks provided by extended family or community-based relationships are likely to amplify the effects of education, experience, and financial capital, facilitating the most advantageous accumulation and utilization of resources such as credit. Networks allow organizations to link to diverse sources of information even in the conditions of lack of deliberate search and lack of entrepreneurial orientation.

As per research carried out by Chandra, Styles, and Wilkinson (2006) entrepreneur prior knowledge and social networks act as “a knowledge corridor” allowing the entrepreneur to identify international business opportunities. Networks supported the internationalization process by providing information (in a subtle way they also replenish poor prior knowledge), reducing perceived risks and providing resources. They offer a counter argument with INV view stating that before the rapid internationalization process, there exists a process of opportunity development which is shaped by entrepreneur experience and networks (Chandra, Styles, & Wilkinson, 2012).

The following hypotheses are developed based on the above discussion

\( H2 \) – Human capital of the entrepreneur significantly influence internationalization

\( H3 \) - Entrepreneurial orientation significantly influence internationalization

\( H4 \) – Social capital of the entrepreneur significantly influence internationalization

\( H5 \) – Owner specific dynamic capabilities significantly influence internationalization

### 2.8 Brand Orientation

Branding in SMEs has been a relatively new area of study and branding among SMEs is still at early stages (Daud & Ghani, 2013; Bresciani & Eppler, 2010a). Because SMEs lack resources and brand management capabilities, branding has been a low priority (Opoku, Abratt, Bendixen, & Pitt, 2007). This does not permit SME to align appropriately with the international environment in which branding has become a necessity rather than an advantage. South Asian SMEs have long focused on their low cost advantage. Increasing labor and energy cost precludes the SME sector of South Asia from gaining any further cost advantage in thrust industries. Interestingly many firms in emerging countries have started to embrace branding strategy to achieve marketing visibility and efficiency (Mcarthur, 2012).

Focusing on a narrow and focused market segment has been a key internationalization strategy among SMEs (Chetty & Campbell-Hunt, 2003). According to Laukkanen, Kompula, and Tuominen (2012) growing number of SMEs in international market have adopted brand orientation. International partners are increasingly becoming conscious about brands that display characteristics of trust, transparency and
reliability (Baumgarth, Merrilees, & Urde, 2013). Especially in South Asia, where the country of origin is associated with a negative aspect, branding gives the competitive advantage they need to overcome the liability of foreignness. In other words the products of developing countries carry low confidence among the international buyers still (Tesform and Lutz, 2006). Currently as most internationalized SMEs of developing countries are heavily reliant on the low cost production which is also the key reason that they were selected by the foreign importers. The issue is however, this carries a risk for SMEs because if labor cost is cheaper in another location, importers would shift their demand provided that the conditions of the new country have become favorable. The SMEs would fail to sustain the internationalization. Increasing cost of labor and energy precludes the SME sector of South Asia from gaining any cost advantage in thrust industries such as tea, rubber and textiles. Therefore in this context where firms advantage is derived through branding (differentiation) more SMEs are becoming internationalized through brand building and positioning the organization/product as quality, flexibility, green, adopter of fair trade policy, etc.

This research posits that BO becomes a DC for SMEs in internationalization because for those SMEs which are highly brand oriented, BO helps to reconfigure and renew the resources in the most advantageous way in response to market requirements. The next hypothesis includes brand orientation.

H6 – Brand orientation significantly influence internationalization

2.9 Industry context

The influence of industry on INV and SME internationalization is less known and many scholars call for more research on firm and environment specific factors to fill this research gap (Andersson et al., 2014; Coombs & Texs, 2009; Fernhaber et al., 2007; George & Zahra, 2002). According to Dunning (2000), it should be expected that some industries (resource seeking activities) and some countries (market seeking activities) show a great propensity to internationalize as per the eclectic theory. According to Andersson, Evers, & Kuivalainen (2014), industry factors affect all dimensions of internationalization. Jones (2011) in a review identified 323 journal articles between 1989 to 2009 on international

entrepreneurship and found only seven focused on industry factors.

Does industry context affect the possession of dynamic capabilities? Some authors argue that industry factors affect the ability of the organizations to form dynamic capabilities (Autio, 2000, 2005). However, empirical evidence is lacking in this area and no quantitative study was found to assess the relationship in SME internationalization as at 2014. This research take the stance that industry factors are influencing the formation of dynamic capabilities in the process of internationalization. Classical articles have implied that the advantage of knowledge based industries is high in dynamic environments (i.e. Miller and Shamsie, 1996 and Bloodgood, Sapienza, and Almeida, 1996) even before the development of dynamic capabilities theory. Firstly, knowledge intensive firms, which are working with knowledge based assets, are more likely to take a learning orientation posture due to their knowledge intensive background. Secondly, the knowledge intensive firms understand and face the risk of technological obsolescence, limited local market size, increasing acceptance of copyrights and patents in all parts of the world, high initial cost in developing knowledge based assets and therefore are prepared to take more risk and are of continuous vigilance of dynamic environment (Baum, Schwens, & Kabst, 2011). Since knowledge is a more mobile resource and have increasingly become a fungible resource, knowledge intensive SMEs have a superior advantage in mobilizing their assets and flexible usage of it. In conclusion, knowledge intensive SMEs have advantages which allow them to rapidly adapt to international environment which closely resemble elements of dynamic capabilities theory such as learning orientation, entrepreneurial orientation and timeliness of strategies (i.e doing it sooner)

It is necessary to identify several classifications of industry structures used by past scholars. In line with the seminal article of Mcdougall and Oviatt (1996), seven industrial characteristics were identified that affect the propensity for internationalization (Fernhaber, Mcdougall, & Oviart, 2007). However the classification of industry as knowledge based or traditional is the most common form of classification in SME internationalization studies. The definition of knowledge based industries can be basically divide in
to three approaches namely input approach, process approach and output approach or a combination.

Knowledge based industry can be defined as “the extent to which industry firms rely on organizational knowledge and learning in order to compete” (Fernhaber, McDougall, & Oviart, 2007). As cited in Bell, Crick, & Young (2004) Covìello defined knowledge-intensive firms as “having a high value added value of scientific knowledge embedded in both products and process”.

Knowledge intensity is a unique resource for internationalization and a key determinant of foreign location advantage that propels internationalization (Kobrin, 1991). Auto (2000) argue that because the mobility of the knowledge as a resource is high, it foster internationalization of business. The nature of knowledge based industries such as targeting new markets, short window of opportunity, insufficient domestic market, more room for strategic error and high capabilities of the founder warrants a tendency to internationalize in a rapid manner than traditional industries (George & Zahra, 2002).

Notwithstanding the considerable understanding of the SME internationalization, there is still inconsistency between what is observed in practice and what the literature indicates with regard to traditional industries. Recent evidence proves that traditional industries are also able to rapid internationalizations (Kalinic & Forza, 2012).

H7 – Industry context significantly influence internationalization

2.10 Organizational Learning

Past literature identifies internationalization as a learning perspective (Zahra, Ireland, & Hitt, 2000; Aulakh, 2009). Erickson (2000) explained internationalization as “a process of learning and accumulation of knowledge” depicting a close link between two variables. Although learning is of key importance in internationalization gradualist theories which states that experimental knowledge is a key input to decision on internationalization, surprisingly few studies have linked organizational learning with SME internationalization (Kauppinen & Juho, 2012).

Past literature highlights that globalization shifts the comparative advantage from developed countries being based on traditional inputs such as land, labor or capital to knowledge (Acs, 2010).

How does the concept of higher order learning apply in internationalization concept? When an SME see differences in local and international environment, signals are collected and the existing theory in use is modified to suit the new environment with or without modifying the mental model (Blomstermo, Eriksson, & Sharma, 2004). If we take brand orientation as an example, a non-brand focused local SME as it expands its international operations may detect the increasing need and advantage of developing brand image, understand this gap and modify their operations to improve their branding capabilities (i.e. increased brand focused advertising, better packaging etc.). This may however take effect in two ways. If the modifications are carried out without modifying the mental model (i.e without developing an organization wide brand orientation), this can be called as lower order learning and vice versa. Higher order learning take place mostly only when organization perceive that branding is fundamental to the firm, or (ii) repeated modifications/corrections in attempting to develop the brand image fails implying a need for a more fundamental shift in the way of thinking.

According to the gradualist theories of internationalization, if internationalization is a phenomenon associated with experimental learning and progress through a chain of establishments, then it is rational to state that the performance or progress from stage to another is dependent on how well the organizations “learn”. Even for international entrepreneurship theories which focus on entrepreneurial characteristics do not imply that decision to internationalize and subsequent performance are as a result of uncalculated and uneducated risks taken by the decision maker. It is assumed that entrepreneurs “always” learn (Thorpe et al., 2005) though according to Minniti and Bygrave (2001), entrepreneurs tend to lock into previous successful patterns called “myopic foresight”. Ruigrok & Wagner (2003) suggest that literature has overlooked the potential moderators of internationalization-performance relationship. It is clear from this argument that learning has an influence on internationalization-performance relationship.

From a more strategic point of view on internationalization, contrary to traditional RBV, in high velocity markets, dynamic capabilities rely
extensively on new knowledge created through experimentation (Eisenhardt & Martin, 2000). In these organizations, managers need to obtain new knowledge and create "temporary competitive advantages" through new resource configuration. In this scenario, the learning orientation of the entrepreneurs of SMEs plays a critical role in internationalization of SMEs and performance through their attitudes towards learning. Despite its key importance in internationalization – performance relationship to date, little empirical research is done to assess the influence of organizational learning (Hsu & Pereira, 2008). As a consequence, how organizational learning influences the scale, scope and timing of internationalization in SMEs is not clear (Hsu & Pereira, 2008).

As stated by proponents of U-shaped internationalization-performance link, at a certain point of this expansion (called internationalization threshold), the costs exceed benefits giving an inverted U-shape. Other scholars disagree with this argument and state that if organizations proactively understand the complexities and costs, properly prepare for it, then organizations are able to reconfigure their process by learning from the experience and the reversion of performance curve will not occur. Therefore it is clear from this argument that learning has an influence on internationalization-performance relationship. Our 8th hypothesis is presented as follows.

\[ H8 \text{ – Organizational learning has a moderating effect on the relationship between internationalization and firm performance of SMEs.} \]

The control variables of this study will be firm size and firm age (Zahra, Ireland & Hitt, 2000; Brouthers & Nakos, 2004). Firm size was considered as a control variable because it gives extraneous variations to SME performance. Firm size affects the availability and access of inputs for the business process such as finance, human resources and physical facilities, and has been shown to influence organizational performance (Tippins and Sohi, 2003).

5. CONCLUSION

Notwithstanding increased favorable environment, internationalization benefits and government support, SMEs still underrepresented in international trade. In addition, South Asian SMEs engaged in exports face unique issues. Despite decades of research, SME internationalization theory is still inconclusive. Many argue that this is because research has considered only fragmented aspects of internationalization. Because internationalization is a complex phenomenon, it is unlikely that one particular theory can fully explain it. This study adopts a multi-theoretical perspective and integrates several theories and variables into a single framework underpinned by DCs theory, in the belief that this will provide a better understanding. Although DC perspective is highly relevant to internationalization context, little has been done to relate it to internationalization.

To understand the empirical issues, past research studied SME internationalization with EO, SC, HC, Industry and performance with theoretical support. However, a long standing inconsistent relationship among the variables are observed. To provide an explanation of inconsistent findings, this research argue that EO, HC or SC of entrepreneur are only elements of DCs required for internationalization (Zahra, Sapienza & Davidson, 2006; Teece, 2007; Castanias & Helfat, 2001; Fernhaber & Li, 2013). To develop DCs, entrepreneur needs to secure all dimensions as they play a complementary role (Mort & Weerawardena, 2006). Hence a new composite variable named “owner specific dynamic capabilities” is introduced in the proposed conceptual framework. The effect of internationalization on performance is further studied with moderating effect of organizational learning.

In addition, SME internationalization includes unexplored dimensions that recently attracted research attention. Dimensions such as Brand Orientation appear to be worthy of investigation in South Asian context.

This research will provide some insights for policy makers in designing and providing the incentives for SME sector in South Asia to enter global market. A significant relationship among the variables should encourage SME owners to ponder of the potential advantages of branding, and develop effective
approach for brand building and also suggest that the SME owners need to cultivate an organization environment that is conducive for higher order learning and entrepreneurship behavior. From the policy makers’ perspective, if the model is validated, it will encourage policy makers to target assistance to the relatively smaller proportion of firms that have the principal founder/manager profiles and industries that are significantly associated with a SME being an exporter and it will motivate policy makers to facilitate setting up of networks for SMEs with a view to promoting internationalization.

Figure 1 - Proposed conceptual framework

6. REFERENCES


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