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The effect of SME internationalization motivators on initial and successive international market entry mode choice

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Abstract

The paper investigates the international expansion of small and medium-sized enterprises (SMEs) taking a sample of United Kingdom (UK) manufacturing SMEs. It focuses on the critical first and less risky step towards internationalization and separates the motivators in Home country and Host country. Using correlation and regression analysis it investigates 44 specific high impact pre-selected internationalization motivators from the literature and tests their effect on the firm's initial entry mode decision and latest entry mode decision. Contrasting the Uppsala and Resource-based view perspectives (using a sample of UK independent manufacturing SMEs and utilizing a survey, correlation analysis and binomial logistic regression analysis), the paper finds and describes the effect of the most recurrent motivators from the literature on the SMEs' first and latest decision to internationalize. The literature and empirical work on the topic has been fragmented and conflicting focusing on specific motivators but not necessarily justifying the selection or origin of variables even less on SMEs or taking into account regionalization. Results show that first entry mode choice affects subsequent entry mode choices and both are mostly affected by home country-specific, internal, motivators as opposed to host country-specific reactive motivators. The paper presents significant results for policy and management regarding SME internationalization and promotion of international activity.

Keywords: SME, internationalization, entry mode choice, exporting, manufacturing

1. Introduction

1.1 Entry mode selection literature review and background

Research in the area of entry-mode selection (including exporting motivation) has mostly been theoretical and under researched (Anderson & Gatignon, 1986; Bower, 1986; Calof & Beamish, 1995; Dunning, 1988; Hennart, 1989; Hill, Hwang & Kim, 1990; Leonidou, Katsikeas, Palihawadana & Spyropoulou, 2007; Root, 1987; Tan, Brewer & Liesch, 2007) The existing empirical research has mostly focused on the manufacturing sector (Clegg, 1990; Gatignon & Anderson, 1988; Trimeche, 2002) or entailed a mix of sectors and industries (Harrigan, 1981; Kogut & Singh, 1988) . Research on the SME services sector has seen a rise in research albeit smaller (Agarwal & Ramaswami, 1992;

Brouthers, Brouthers & Werner, 2003; Erramilli & Rao, 1993). The factors that make SMEs grow (including export) are still in need of research (Bamiatzi & Kirchmaier, 2014). Regardless of sector though, up until today the entry mode research and pre-internationalization motivation research conducted on large multinationals is still larger than on small and medium-sized (SME) firms. Nevertheless, SMEs are significant players fuelling economic growth and innovation in the international playing field and whilst their economic impact may not be necessarily as great as that of larger multinationals, SMEs have been the fastest growing segment in international trade (Etemad & Wright, 1999).

The paper focuses on the United Kingdom (UK) manufacturing sector as manufacturing (although declining in importance domestically) still represents 54% of UK exports, employs 2.6million people and the UK remains the world's 11th largest manufacturer. Along with the United States of America, the European Union (EU) is the UK's main export destination. According to the European Commission (2005), enterprises that expand abroad reported profit/sales ratios of 7.9% as opposed to 4.2% of those who do not. Internationalizing SMEs not only conduct more R&D, but also produce more patented products. In international business research, it is generally suggested that there is a positive relationship between international involvement and firm performance (Hilmersson, 2014) by the motivations behind international involvement are still in need of research. By internationalization it is meant exporting, franchising, licensing, joint-ventures and foreign direct investment (in order of increasing resource commitment). By first move it is meant the first international expansion since inception. By latest move it is meant the latest international expansion (not the first). Firstly, the paper examines the background to SME internationalization and defines motivators. Secondly, the paper separates motivators in home and host for extra depth of analysis and presents the hypotheses, methods and results. Finally, the concluding remarks are presented.

1.2 Internationalization motivators defined

According to Leonidou, Katsikeas, Palihawadana & Spyropoulou (2007) internationalization motivators can be separated into proactive/reactive and internal/external; internal being those that derive from within the firm and external from the environment. Motivators are the difference between *must* and *want* and are situational (ie. act at one point in time) and generally consist of variables (reactive and proactive, home and host) such as unsolicited orders, size, and common market membership (Driscoll, 1995;

Kuada & Sørensen, 2000). The nature of the stimulus may also determine the firm's internationalization path and hence its survival and success; e.g. Ill-prepared or weakly stimulated firms will be more likely to struggle. This paper, focusing on the EU stimulus, separates them into home country-specific and host country-specific depending on their derivation, this is in order to emphasize and test the power of the motivators arising from the foreign (host) market and what role they play. Not all home country variables are proactive, i.e. not all initiate from within the firm, such as domestic competition (Leonidou, Katsikeas, Palihawadana & Spyropoulou, 2007). The paper focuses on the home country and host country division as it is deemed important to view the effect from a country level perspective since we are discussing international expansion from one country to another. The 44 variables selected are presented in the methodology section and are recurring in the literature and either deemed of very high and high impact by Leonidou, Katsikeas, Palihawadana & Spyropoulou (2007) or are clear host country-specific.

Motivators can describe why some firms prosper in international activity while others remain inactive (Bilky, 1978). Firms motivated by home pressures are less likely to engage in higher risk modes of entry due to their inertia, lack of know-how, and their being risk-averse, as we shall explore further on. As Burpitt and Rondinelli (2000) state firms willing to spend time in the learning process are more likely to survive longer in exporting even when financial returns fade away; this bias towards incremental learning is very common amongst SMEs, particularly risk-averse ones. Leonidou (2004) divides exports barriers into internal and external. This paper focuses on the motivational barriers subdividing them into home country and host country. As Leonidou, Katsikeas, Palihawadana & Spyropoulou (2007) state that the stimulation effort is generally based on reactive factors and this may lead the firm into problematic export paths, the effort should be based on proactive (initiated strategically by the firm) factors (e.g. Strengths, excessive capacity, identifying foreign market opportunities) as each opportunity is examined carefully to ensure that it conforms to the company's goals for profits, sales and is overall strategic export plans.

1.3 Hypotheses and analysis

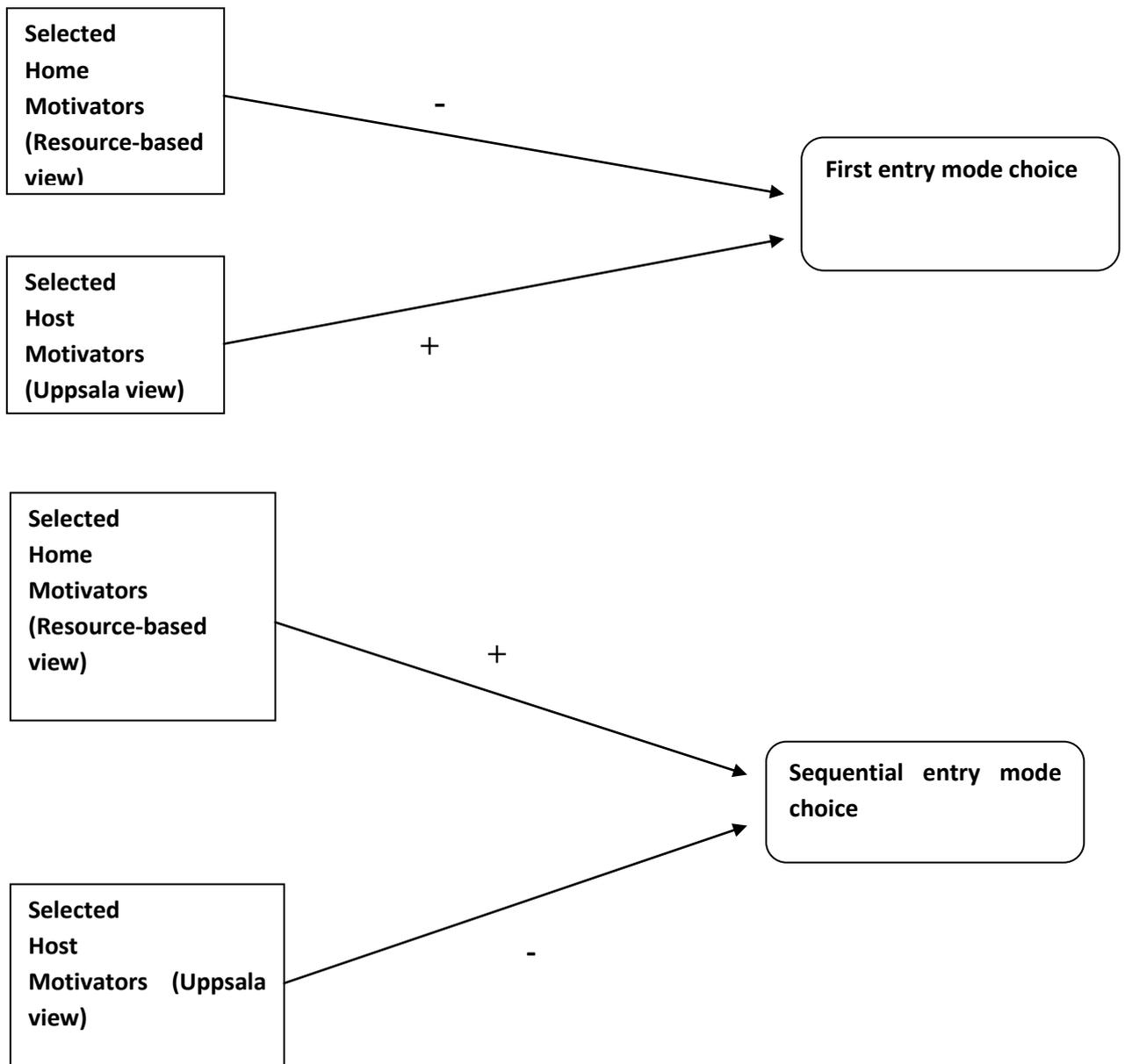
Reacting to specific opportunities can be a critical competitive advantage for SMEs, although not all managers generally seize it. It is fact that many firms establish their first business contacts by reacting to an initiative, or establishing contacts in trade fairs for example. By acting rapidly, i.e. following a proactive home country motivator, they can

realize new opportunities that open with changes in the network, initiatives by existing partners or new entrants to the network. Social networks intertwined with professional ones seem critical in identifying opportunities. Thus, for managers this implies that they will have less control over the evolution of their international business. Capabilities must be built with a long-term perspective, particularly if we take into account SMEs' size disadvantage in terms of survival rates (Agarwal & Audretsch, 2001), and include country-specific expertise as well as the establishing and maintenance of networks for example and routines (Eisenhardt & Martin, 2000).

It is important to view the EU common market as a significant motivator and this is because of the advantages it provides to the SME; red tape and border bureaucracy has been significantly reduced, trade within the EU has risen by 30% since 1992 (European Commission, 2007). Obstacles can be overcome if detected on time and if the SME can understand which motivators affect its internationalization process enabling the SME to design a better strategy to overcome the perils of international markets and foreign exposure, particularly outside of the EU common market (Baird, Lyles & Orris, 1994; Namiki, 1988).

Home country, more proactive, stimuli are implied to be associated with subsequent entry mode choices. The entry modes are classified by commitment level as per Pan and Tse (2000); specifically in order of commitment exporting, licensing, franchising, joint-venture, and foreign direct investment. The higher the entry mode (ie. The higher value of the variables "first entry mode" and "latest entry mode") denotes a choice of higher commitment entry mode (Pan & Tse, 2000). Following the Uppsala model perspective of reactive incremental learning and experiential knowledge common amongst SMEs (Bilkey and Tesar, 1977; Johanson and Vahlne, 1977, 1990) and Barney's (1991) proactive resource-based view of internal competences (Dhanaraj & Beamish, 2003; Lin & Wu, 2014; Peng, 2001; Terziovski, 2010; Westhead, Wright & Ucbasaran, 2001), the paper aims to investigate whether the hypothesis that reactive (host country-specific) are more prone to lead to risk-loving initial expansion, than proactive (home country-specific) motivators which lead to successive expansions (Cavusgil & Nevin, 1981; Reid, 1983; Leonidou, Katsikeas, Palihawadana & Spyropoulou, 2007) is true. In other words, that the SMEs' first move is a reactive move rather than a strategic move planned internally.

Figure 1 The associations tested by the model and hypotheses.



Hypothesis 1: Host country-specific motivators are positively associated with the firm's first entry mode choice

Hypothesis 2: Home country-specific motivators are positively associated with the firm's latest entry mode choice.

2. Methods

2.1 Participants

The definition of SMEs adopted by the study is the EU SME definition of 2003 (European Commission, 2003). Any firm established 5 years or less before its first

international move is defined within the literature as a born global (McDougall, Shane & Oviatt, 1994). The paper does not take into consideration Born Global firms as it focuses on already established firms whose age (Evans, 1987; Navaretti, Castellani & Pieri, 2014), resources and experience (particularly for experienced firms) may be a motivator for exporting as Bernard and Jensen (2004) demonstrate. Created from representative sampling, questionnaires with Likert-type scales (i.e. 1 for lowest importance of the variable to 7 as highest, with 4 as median) were sent out during the period of 2010-2011 to all the 648 independent SMEs (i.e. not subsidiaries) working within manufacturing in the UK which have been singled out from the EXPERIAN database (Experian, 2015); the aim was to collect opinion, behavioural and attribute variables on the significance of the particular motivators and the reasons behind the firms' decisions to export within or outside the EU. Of the 103 respondents, including missing data, the majority were medium sized firms (60%).

As the response rate for SME surveys is not usually very high, e.g. 10-15% is an acceptable response rate (Jobber and O'Reilly, 1998; Dennis, 2003), the paper targeted all of the enterprises from the sources of data and achieved a response rate of 15.9% (103 of 648) including the non respondents and the ineligible. The non respondents were analyzed and were all refusals and not eligible. The year of establishment of the sample's firm ranges from 1920 to 2004, with the majority of the firms having registered with companies house (and hence been established) between 1981 and 2004. Following the methodology, as representative sample a sample of 648 independent and registered SMEs with international activity were singled out, which was the sampling frame. The questionnaires were sent to the CEOs of each SME as strategic decision makers and included a reference letter from the UK Forum of Private Business and the questionnaire to be sent back in the pre-paid envelope. In line with the research of John (1984) regarding selecting knowledgeable informants, the choice of this respondent group being selected was based on the belief that people in these positions are most knowledgeable on international investment projects and the dynamics of the overall foreign entry decision process.

2.2 The survey

Surveys conducted on SMEs are known for being harder to administer than those for larger firms due to the small response rates, and as Dennis (2003) states, SME surveys are generally harder to administer. This study has achieved a good response rate of above 15%

by following up extensively (Leonidou, 1995; Jobber, 1986). As Greer, Chuchinprakarn, & Seshadri (2000) state the content of the study is the most important element to achieving a higher response rate and that is why the study was also accompanied by a reference letter from the UK Forum of Private Business. Created from probability (representative) sampling, questionnaires with Likert-type scales were sent out during the period of 2010-2011 to all the independent SMEs working within manufacturing in the UK which have been singled out from the databases. The SMEs had to be independent in order for them to be able to make their own choices and select their own strategies, along with being responsible for utilising their own resources. The year of establishment of the sample's firm ranges from 1920 to 2004, with the majority of the firm having registered with Companies house (and hence been established) between 1981 and 2004. Of the respondents who answered the entry mode question the majority (81.6%) were exporters as expected (Jones, 2001).

Reliability analysis using Cronbachs' alpha showed $\alpha = 0.83$, thus the questionnaire has good internal consistency has reliability within the acceptable limits. A total of 105 questionnaires were returned from a total of 648 questionnaires sent out, out of which 103 were complete and 2 were not, i.e. they were missing over 30% of their data (See Acock, 2005). Evidence supports that universal constructs do not exist for these variables, therefore appropriate scales had to be constructed using the literature on SME motivators (e.g. Kim & Hwang, 1992; Leonidou, Katsikeas, Palihawadana & Spyropoulou, 2007), thus the scale of 1-7 was deemed most appropriate for the discrete variable (as seen in table 1).

Table 1 Motivators tested

	Motivator	Scale	Home-Country based	Host-Country based
Internationalization characteristics	Firm's first entry mode	1-5 (exporting, licensing, JV,FDI)	X	
	Firm's latest entry mode	1-5 (exporting, licensing, JV,FDI)	X	
	Latest country entered was EU?	1-2	X	
Firm level stimuli	Degree of customization	1-7	X	
	Ability to produce differentiated products	1-7	X	
	Products based on new combinations of tested technology		X	
	Firm size (no. of employees)	1-2 (small or medium-sized)	X	
	In-house research	1-7	X	
	Uniqueness of products	1-7	X	
	Strength of prices and products	1-7	X	
	Importance of size	1-7	X	
	Excess capacity	1-7	X	
	Accumulation of unsold inventories	1-7	X	
	Unsold inventories	1-7	X	
	Capability to develop products	1-7	X	
	Ability to service products	1-7	X	X
	Patents held	1-7	X	
	Understanding of customers needs	1-7	X	
	Quality of products	1-7	X	
Extent of customization	1-7	X		
Extent of new technology	1-7	X		

	combinations			
	Extent of new external technology	1-7	X	
	Extent of new in-house technology	1-7	X	
	Extent of R&D	1-7	X	X
External stimuli	Importance of receipt of unsolicited order	1-7		X
	Economic stability UK	1-7	X	
	Economic stability HOST	1-7		X
	Repatriating income HOST	1-7		X
	Legal restrictions UK	1-7	X	
	Legal restrictions HOST	1-7		X
	Legal incentives UK	1-7	X	
	Legal incentives HOST	1-7		X
	Acceptability of firm's products UK	1-7	X	
	Acceptability of firm's products HOST	1-7		X
	Market potential UK	1-7	X	
	Market potential HOST	1-7		X
	Network wholesalers UK	1-7	X	
	Network wholesalers HOST	1-7		X
Managerial Characteristics	Position of decision maker	1-7	X	
	international experience of CEO	1-7	X	
	SME's international experience	1-7	X	
	Decision maker's knowledge of foreign markets	1-7	X	
	Desire for a larger market	1-7	X	
	Quality of management	1-7	X	

In detail, out of a total of 648 independent firms singled out, all were surveyed along with 42 more receiving a second round. The relationships presented in the research model above were examined using binomial logistic regression and correlation analysis as in previous SME work (Albornoz, Pardo, Corcos & Ornelas, 2012; Keizer, Dijkstra & Halman, 2002; Kmiecik, Michna, & Meczynska, 2012; Shih & Wickramasekera, 2011; Yee-Loong Chong, Ooi, Bao & Lin, 2014). Spearman's rho was used to explore the relationships between (all) the independent variables and (both) the dependent variables. A priori power analysis reveals that for a two-tailed t-test, a medium effect size $d = 0.5$, a significance level of $\alpha = 0.05$, and a power $(1-\beta)$ of 0.7, the required sample size is 100; Thus making the sample size of 103 adequate.

3. Results

The following 9 variables out of the 44, i.e. motivators, examined showed significant results as presented below, in table 2, separated by first and latest entry mode choice:

Table 2 Results

Significant motivator	Dependent variable: First entry mode choice	Dependent variable: Latest entry mode choice
Increased domestic competition (<i>Home</i>)	(rs = -0.2, p = 0.05)	-
Market potential UK (<i>Home</i>)	(rs = 0.3, p < 0.01)	-
Market potential Host (<i>Host</i>)	(rs = 0.2, p = 0.02)	-
Uniqueness (<i>Home</i>)	(rs = 0.3, p = 0.01)	-
Size as weakness (<i>Home</i>)	(rs = -0.2, p = 0.02)	-
First entry mode (<i>Home</i>)	-	(rs = 0.3, p < 0.05)
Competitor beginning to export (<i>Home</i>)	-	(rs = 0.2, p = 0.05)
Government policy (<i>Home</i>)	-	(rs = 0.2, p = 0.05)
EU membership of the UK (<i>Home</i>)	-	(rs = 0.2, p = 0.05)

3.1 Significant motivators associated with first entry mode selection

3.1.1 Increased domestic competition

This home country variable shows a modest negative relationship with first entry mode choice showing that as domestic competition increases, the SME will opt for lower

commitment modes of entry. This could be due to the risk awareness of companies who reactively internationalize due to increased domestic competition, while those who proactively exit even though domestic competition is low may show a preference for higher commitment modes. Due to European integration, competition has escalated, in both national and international markets; Thus, almost one-third of SMEs have proceeded to increase the number of international business contacts in the recent years. Management under hostile and benign environments is critical for strategy and many times calls for internationalization (Covin & Slevin, 1989).

3.1.2 Market potential UK

This home country variable shows a modest positive relationship with first entry mode choice. Market potential in the home country, i.e. Consumer spending power, demand and competition, denotes the level to which the firm's local market provides the opportunity for immediate or sustainable profits; the same can apply to foreign markets. This relationship shows that there is a potential link between higher potential in the local market and higher entry mode choices in foreign markets. This may be explained by the fact that higher entry modes require higher levels of investment, risk and assets, which may be provided by a local market with high potential as opposed to reactive lower entry modes (Johansson & Vahlne, 1977;1990).

3.1.3 Market potential Host

This host country variable shows a modest positive relationship with first entry mode choice. Market potential in the host country was seen as most significant host country attribute leading to international ventures. Host Market potential is a typical instigator and acts as an instigator for a proactive firm with international expansion and exporting in mind, or even for proactive ex-internationalizers and born again globals to be able to undertake internationalization and undertake it with a high level of investment. This variable and market potential in the UK could sometimes act simultaneously. As Covin and Slevin (1989) point out hostile environments require entrepreneurial strategy while benign and more familiar environments require a more conservative, risk-averse, strategy for survival.

3.1.4 Uniqueness

This home country variable shows a modest positive relationship with first entry mode choice. Uniqueness refers to the uniqueness of the firm's products; i.e. to what extent can they be imitated, to what extent they can be recreated or transferred to another market and how fast can they be replicated (Barney, 1991). Uniqueness is a source of competitive advantage for the firm and it is thus a home country motivator. The competitive advantage created by have a unique product can be replicated abroad and this is a strong motivator for a firm to engage in international activities (particularly in conjunction with other possible motivators such as networks in a host country). According to Tödting and Kaufmann (2001), SMEs innovate in different ways to larger firms, as they command fewer resources, will have less R&D and face more uncertainties and barriers to innovation than larger enterprises.

3.1.5 Size as weakness

This variable examines to what extent is size seen as a weakness by the SME and thus how does it affect entry mode choice. It seems there is a modest negative relationship with first entry mode choice ($r_s = -0.2$, $p = 0.02$) as logically size is seen as being critical and the more a manager sees being small as a weakness, the lower will be the investment in international markets. As Calof (1993) shows firm size is positively associated with the number of markets a firm reaches out to. Size is an omnipresent factor when talking about SMEs or studying SMEs, it is assumed by many to be the critical factor in any SME strategy, as it is made out of resources, and resources denote size. As Fiegenbaum and Kamani (1991) state, SMEs may see size as a burden, yet size allows for output flexibility and the ability to reshape a strategy and adapt faster. The size of the firm is one of the main barriers that the firm can encounter (Calof, 1993).

3.1.6 SME International experience

This home country variable showed a modest positive relationship with first entry mode choice. The manager can have international experience with any firm, or with an SME and it is a critical motivator for the firm, as it can help it overcome a variety of obstacles including costs and legal obstacles through experience and ingenuity (Knight, 2000; Reuber & Fischer, 1997). It is not coincidental that of our sample of

internationalizing SMEs almost all managers had 10 years or more of international experience with an SME or with any kind of firm As Reuber and Fischer (1997) point out internationally experienced management teams have a greater propensity to develop foreign strategic partners and to delay less in obtaining foreign sales after start-up, and that these behaviors are associated with a higher degree of internationalization.

Characteristics that have been found to predict propensity for internationalizing include: the extent to which the manager had engaged in foreign travel; the number of languages spoken by the manager; and whether the top decision maker was born abroad, lived abroad or worked abroad (Meisenbock 1988; Reid 1983). Firms that are international from birth are typically founded by a team of individuals with international experience (Oviatt & McDougall, 1994). Finally, Ghoshal (1987) has argued that organizations that internationalize earlier and obtain foreign sales faster are likely to develop fewer routines and resources which make it difficult for them to move out of domestic markets.

3.2 Significant motivators associated with latest entry mode selection

3.2.1 First entry mode

This variable shows a modest positive relationship with the SME's latest entry mode choice . The first move tends to be trade related and is very critical to the firm along with the initial pre-export phase (Jones, 2001; Wiedersheim-Paul, Olson & Welch, 1978) It seems for many SMEs the initial entry mode choice affects the choice of further subsequent moves; this may be due to experiences gained (positive or negative), networks built in specific countries (Rangan, 2000),lack of qualified employees, lack of managerial skills, and potential risk-averse attitude towards foreign markets (Johnansson & Vahlne, 1997;1990) and a slower rate of incremental learning.

3.2.2 Competitor beginning to export

A direct competitor beginning to export is a clear host country variable leading the firm to internationalize just to maintain market share, and stay in the game. It would rarely (unless the competitor decides to expand far) lead to expanding further away. This variable shows a modest positive relationship with latest and subsequent entry mode choice as SMEs reactively follow competitor's moves into foreign markets, possibly due to the effect of government policy (also related) or a saturated domestic market.

3.2.3 Government policy

As government policy is (mostly) considered a barrier (Leonidou, 2004), it is expected, unless beneficial, to lead to exploring foreign markets. The variable shows a modest positive relationship with latest entry mode choice. Government policy can determine the final entry mode that the firm selects and can force the firm to change or stop its plans for expansion, as a moderator. Government policy could be a subsidy towards SMEs or a training program, or could be the opposite, for example heavy taxation. For a firm ready to internationalize motivated by a specific motivator such as a firm specific advantage a change in government policy towards higher strict measures such as taxation would alter the firm's plans and slow down its internationalization if not end it, according to the costs it can bear, to the level of experience of the manager or the strength of its competitive advantage. The firm naturally, after being instigated by a motivator (s), naturally has a "desired" entry mode and export intensity in its mind, yet this is redirected, stopped or boosted by variables such as government policy which block the firm's actions or inhibit them, forcing it at times to alter and change plans completely.

3.2.4 EU membership of UK

This variable shows a modest positive relationship with latest entry mode choice, as the EU common market and membership of the UK provide a platform for many reactive managers to venture abroad. The variable is a home country variable but is directly linked to the EU common market which in turn exerts a "pull" effect on UK SMEs due to the fall in red tape and barriers to internationalization. As the "pull" pressures from the host country rise so does the firm's motivation to venture abroad outside of its own safety net within the EU and follow its internationalization plans with a more risk loving strategy. If the host motivators come from a non-EU country their power, as is shown, is strong enough to lure the firm that accepts them into internationalizing outside of the EU overcoming psychic distance at times in a much more rapid manner than that suggested by Johansson and Vahlne (1977) in their work on gradual expansion.

4. Conclusion

The variables examined for first and latest entry mode choice were the same as listed above for both hypotheses, yet the ones that showed a relationship were different for first

and latest entry mode choice. This indicates that managers and the SME view the first and latest moves differently and are instigated by different motivators. In addition, almost all of the motivators, except market potential of the host country, were home country variables (i.e. Linked to innovative behaviour and proactiveness) which calls for further investigation particularly for hypothesis 1. This can be seen by the positive relationship between first and latest entry mode choices, hinting that SMEs' subsequent choices may be directly affected by their initial first entry mode choice but that initial choice is not necessarily motivated only by reactive(host country) stimuli and incremental learning including bias. This also calls for further investigation. Policy makers should aim to encourage managers of SMEs to become more proactive and actively engage in international activity from the start, to actively seek opportunities, and should aim to provide a stable platform for launch of the SME's internationalization. Boosting and encouraging the international activities of SMEs is of vital importance for managers and policy itself (Hilmersson, 2014; Knight, 2000; Luostarinen & Welch, 1993) particularly exporting (Hinson & Abor, 2005).

Although the paper focused on analyzing entry mode as a choice and degree of commitment, it would be interesting to see the relationship between specific modes of entry (e.g. FDI) and the variables examined in the paper, particularly first entry mode choice. Boosting and encouraging the international activities of SMEs is of vital importance for managers and policy itself (Knight, 2000; Luostarinen & Welch, 1993). In addition, investigating the determinants of initial mode of entry can encourage reactive managers to become proactive as they are more aware of the potential of their resources, the significance of the pressures they receive and the modes of entry that are feasible for them at that point in time increasing their options and motivation. The results are significant for policy and management as policy makers should seek to encourage, inform, and boost SME international activity for current internationalizers and non-internationalizers.

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