

The Internationalization Theory and Malaysian Small Medium Enterprises (SMEs)

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Abstract—Reduction in trade barriers and development in information and communication technology provide the opportunity for small and medium enterprises (SMEs) to expand their business into foreign market, even on the first day of its establishment. Such circumstances have lead into a debate among internationalization researchers on which theory effectively explain the firm's internationalization process and whether the older theories are not relevant anymore these days. Therefore, the objective of this paper is to look at the internationalization process of Malaysian SMEs and how it fits the internationalization theories. Discussions are based on the related theories of internationalization namely the Uppsala Model, Network Approach and International New Venture or Born global. This paper also presents a descriptive analysis on the level of internationalization among Malaysian SMEs, reason for internationalization, the mode of entry used, and the reason for non-internationalization among firms that have no international activities. Data were collected through self-administered questionnaire and a total of 250 responds were received. Findings indicate that all three theories are still applicable as not all SMEs that internationalized are born global in nature. Exporting was the most used mode of entry and increasing profit was the main reason for internationalization. Potential difficulties and uncertainties in making profit appear to be the major reason for non-internationalization. Discussions of the findings, significance of the study and direction for future research are then discussed.

Index Terms—Born Global, Internationalization, Internationalization theory, Small and Medium Enterprises (SMEs),

I. INTRODUCTION

Globalizations together with the reduction in trade barriers and tariff due to regional economic integration and World Trade Organization (WTO), together with the development in information and communication technology provide the opportunity for small and medium enterprises (SMEs) to expand their business into foreign market. Undoubtedly, SMEs play an increasingly active role in international markets in recent years and rapidly expanding their businesses to international markets, using international diversification as an important strategic option to achieve growth [1]. Significantly, in East Asia, 90 percent of all business enterprises are SMEs which suggests that they have a strong role in enhancing their nation's employment,

economic and social development. Moreover, SMEs is also a source of innovation, generating exporting opportunities, and as the source of future successful large-scale enterprises [2].

According to Malaysian Productivity Corporation (2007), SMEs contribute about RM4.3 billion or approximately 20 % of the Malaysian gross domestic product (GDP) in 1990. In 2007, its contribution had increased to about 32 per cent of GDP, an increased of 12 per cent in 17 years [3]. SMEs in Malaysia were affected by the global financial crisis that unfolded in 2008, but able to recover in late 2009 and recorded a contribution of 31.2 % of the Malaysian GDP for that year [4]. The increased in its contribution to total GDP over years signify that SMEs has the potential to promote domestic-led growth in existing and new industries, and to strengthen the resilience of the economy in an intensifying global economic competition. Compared to other countries, Malaysian SMEs have contributed a creditable share as Germany recorded 57% share, Italy 36.7 %, Taiwan 31.4 %, Japan 20.3 % and Republic of Korea 16% [5].

Its contribution to country's economic growth makes the study on the internationalization of SMEs very popular among researchers. There are many studies conducted on SMEs internationalization from various perspectives and among them are the process of internationalization [6],[7], factors for internationalization [8],[9],[10] and barriers to internationalization [11],[12],[13]. Various definitions of internationalization were being used by researchers and it varies depending on the interest and phenomenon of the study. It has been describes as the process of adapting firms operations (strategy, structure, resource) to international environments [14]. Other definition describes internationalization as a gradual process whereby a firm develops a network of global trade relationship [15]. Javalgi, Griffith and White [16] then look at most of the literature on internationalization and summarize it as a process through which a firm moves from operating in its domestic marketplace to international markets. Among the factors that motivate SMEs in entering overseas markets include market expansion, more profit and exposure to new ideas [17]. On the other hand, barriers to internationalization among SMEs are shortage of capital [11], management characteristics and attitudes [18], lack of knowledge of potential markets and how to enter the markets, and also lack of qualified staff [19].

Despite the huge numbers of studies on SMEs internationalization available, there are only a few studies that focused on Malaysian SMEs. It limits the understanding on the level of internationalization, why and how SMEs in Malaysia internationalized their business, and what are the barriers faced by these Malaysian firms among those who did not internationalize. A closer look at the previous Malaysian

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SMEs internationalization studies also reveals that there are no effort been done to specifically look at the internationalization theory and which one best explains the internationalization process of Malaysian SMEs. Therefore, the objective of this paper is to increase the current level of understanding on the level of internationalization by Malaysian SMEs, why and how they internationalize and the barriers faced. Another objective is to look at each internationalization theory proposed by various researchers and find out which one best explain the internationalization process of Malaysian SMEs.



Source: Adopted from Johanson and Vahlne (Johanson et al., 1977, p.26)

Fig. 1. The Uppsala Model

II. DEFINITION OF SMES

In Malaysia, the term SMEs is often used interchangeably with small and medium scale industries 'SMI' [20], [21], [22]. There were no common definition of SMEs among the different Malaysian agencies and institutions and it is necessary to introduce standard definitions for SMEs since the definition used at that time mainly refers to the manufacturing sector. Small and Medium Enterprise Corporation Malaysia (SMECorp) [23] underline 2 criteria that characterize the standard definitions of SMEs in Malaysia, which is the number of employees or annual sales turnover. These apply to four main sectors; primary agriculture, manufacturing (including agro-based), Manufacturing-Related Services (MRS) and Services (including information and communication technology). Table 1 shows the range of current SME definitions in Malaysia.

TABLE 1: STANDARD SMES DEFINITIONS IN MALAYSIA (AS OF JANUARY 2011)

Size	Number of Full-Time Employees		Annual Sales Turnover	
	Manufacturing (including Agro-based & MRS)	Services Sector (including ICT and Primary Agriculture)	Manufacturing (including Agro-based & MRS)	Services Sector (including ICT and Primary Agriculture)
Micro	Less than 5 full-time employees	Less than 5 full-time employees	Less than RM250,000	Less than RM200,000
Small	Between 5 and 50 full-time employees	Between 5 and 19 full-time employees	Between RM250,000 and less than RM 10 million	Between RM200,000 & less than RM1 million
Medium	Between 51 and 150 full-time employees	Between 20 and 50 full-time employees	Between RM10 million and RM25 million	Between RM1 million and RM5 million

III. INTERNATIONALIZATION THEORY

This paper will highlight three most commonly cited internationalization theories, known as the Uppsala model, Network approach and international New Ventures or also known as Born Global.

A. Uppsala Model

The Uppsala model is a theory that explains how firms gradually intensify their activities in foreign markets, and it is being introduced by Jan-Johansson and Jan-Erik Ahlen in 1977 [24]. Their model emphasized the gradual and incremental character of international expansion. Organizations could best reduce their risk level by adopting this approach. Incremental growth also suggests that companies begin internationalization process in markets that have less psychic distance. Psychic distance can be defined as the individual's perceived differences between the home and the foreign country [25]. Figure 1 shows the usual path followed by firms during internationalization based on the Uppsala model. The theory states that the firms with no exporting activity will start by exporting via an agent. Firms may also use other entry modes such as joint venture, licensing or franchising and it depends on the nature of the firm. Gradually, firms will gain more market knowledge and use more intensive and demanding operation modes such as sales subsidiaries and followed by wholly owned subsidiaries.

B. The Network Approach

Johanson and Mattsson [26] introduced 'The Network

Approach to internationalization' that highlights the importance of relationships with suppliers, customers and market that can stimulate or help a firm to go abroad. Networking is seen as a source of market information and knowledge that will bridge the gap between the involved parties' customers, suppliers, the industry, distributors, regulatory and public agencies as well as other market actors. Development in technology especially in information and

communication sector help firms achieve a faster internationalization through the experience and resources of network partners [27]. The establishment of financial, technological and commercial relations with the other actors of the network makes it possible to the firms to extend their connections and to gradually widen their activities apart from their own territory until becoming international. These relations involve the firm in deliberated but not planned international relations [26]. For small and medium size firms, the network approach is seen as a feasible route towards internationalization as their membership to the network will help firms positioned itself in a foreign country.

C. International New Ventures/Born global

Nowadays, technological advancements and declining trade barriers are driving the world economy to become integrated and rapid globalization is enabling SMEs to internationalize in a quicker yet effective manner [1]. As a result, some scholars question the validity of the Uppsala model and the network approach, and argue that the model is no longer explain the internationalization of today's firms as more firms nowadays are international from inception such

as Yahoo, Amazon and Ebay. Oviat et al [28] introduced the concept international new ventures (INVs) or also known as “Born Global” to explain this new trend of rapid internationalization. The term INVs and born Global since then have been used interchangeably in many internationalization studies. Oviat et al [28] defined born global firms as business organizations that seek for resources and selling products for gaining competitive advantages from multinational markets ever since the beginning. Later studies however argued that born global firms do not necessarily international from the inception. However, there is no consensus on the period of time taken to internationalize within the literature to determine a born global firm. Ronnie (1993), classify born global firms as those which beginning exports on average within two years of the firm’s establishment. On the other hand, Knight and Cavusgil (1996) said that firms must reached foreign sales of at least twenty five percent within three years of establishment. However, Wickramasekera and Barberry [29] have stated that INVs/Born global are firms that start their international operations within six years of establishment and it seems to be emerging as the most favored definition. Therefore, this study will also use that criterion in classifying INVs/Born global firms in Malaysia.

IV. RESEARCH METHODOLOGY

Data for empirical analysis were collected via self-administered survey questionnaire. The population of this study is Malaysian-based SMEs that either are currently engaged in international business activities or those who currently serving the local market only. The sample was composed of SMEs that participate at various SMEs related exhibitions and expos, organized by various government agencies. Exhibitors consist of SMEs from all around Malaysia and from various industries. 400 SMEs are randomly selected from the list and questionnaires were distributed to the key informant of the company during this exhibitions and expos organized at three states; Johor, Selangor and Kuala Lumpur. 250 completed and usable questionnaires were returned making the overall response rate was 62.5%. The data was then analyzed using SPSS 14 software in order to obtain the result.

V. FINDINGS

In terms of key informants, 95 or 38% of the respondents are at the managerial level while 66 are managing directors (26.4%). Others are assistant manager 37 (14.8%), CEO 30 (12%) and executive/supervisor 22(8.8%). Table 2 shows the profile of each company where majority of the SMEs came from food and beverage industry with 99 firms (39.6%). This is followed by textile, apparels and leather industry with 35 firms (14.0%), healthcare 11.2% (28 firms). Other industries include wood and wood products industry 27 firms (10.8%), plastic products 20 firms (8.0%), rubber products 15 firms (6.0%) and other industries 7 firms (2.8%). More than half of the SMEs employs between 51 to 150 employees with a combine percentage of 62%, while another 21.2 % or

53 SMEs have between 5 to 50 employees. 42% SMEs have less than 5 employees or 16.8%. In terms of annual turnover, majority of them earn between Ringgit Malaysia (RM) 10.1 to 25 million a year, while the rest earns between RM 250k to 10 million. 42 companies or 16.8% however earn less than RM 250k. Based on the number of employees, turnover and classification shows in Table 2, it can be said that majority SMEs in this study are medium in size. Table 2 also indicates that more than half of the SMEs involved in this study did not involve in any international business activities with 141 firms (56.4%), while 109 (43.6%) do internationalize.

Table 3 highlights the main reason why Malaysian SMEs internationalize. Increase profits (40 firms, 36.7%) top the list, followed by market opportunity where 26 (23.9%) respondents chose this reason. Other reasons which are entrepreneur motivation (15, 13.8%), business expansion (14, 12.8%) and market for product (14, 12.8%) are also important reasons for foreign expansion. In terms of mode of entry into foreign market, exporting is the most popular method with 81 SMEs or 74.3% use it while other 17 or 15.6% use licensing. Just a small number of companies use franchising, joint venture or wholly own subsidiary as the cumulative percentage for these three modes are only 10.2 %.

TABLE 3: REASON FOR INTERNATIONALIZATION AND MODE OF ENTRY

	Frequency	Percentage
Reasons		
Market opportunity	26	23.9
Increase profit	40	36.7
Business expansion	14	12.8
Market for product	14	12.8
Entrepreneur motivation	15	13.8
Mode of entry		
Exporting	81	74.3
Licensing	17	15.6
Franchising	3	2.8
Joint venture	5	4.6
Wholly owned subsidiary	3	2.8
NOTE: N = 109		

TABLE 4: DOMESTIC POSITION AND INTERNATIONALIZATION PROCESS

	Frequency	Percentage
Domestic position		
INVs	16	14.7
Leaders	5	4.6
Good	50	45.9
Growing	30	27.5
New comer	8	7.3
Process		
Step by step, risk averse, slow and cautious	46	42.2
Through networks, contact or partners	37	33.9
Rapid internationalization and expansion	26	23.9

Table 4 shows the domestic market position when firms start to internationalize and the internationalization process. Majority of the respondents said that the company is either growing or in a good position when it ventures into the foreign market. 24 companies view itself as new comers and INVs and it is almost similar with the number of SMEs that

goes for rapid internationalization process, which were 26 companies. Highest numbers of companies (46) uses step by step approach in internationalization while 37 indicates that it utilize the network

Table 5 list out the reasons or barriers to internationalization, as indicated by 141 SMEs that did not involve in international business activities. Entrepreneurs are unsure of whether internationalization will give them profit or not due to the level of difficulties and uncertainties in foreign market was the most cited reason. 53 firms or 37.6% choose this reason while 35 others (24.8%) are concern over their lack of experience. Difficulties in getting new business network and customers come third with 22 companies (15.6%) followed by the risk and uncertainty in foreign operation (19, 13.5%). Cultural and language differences are not much of a big concern for these SMEs as only 12 firms (8.5%) chose it as the reason.

TABLE 5: REASONS FOR NON-INTERNATIONALIZATION

No	Reasons	Frequency	Percent age
1.	Lack of experience	35	24.8
2.	Risk and uncertainty of foreign operations	19	13.5
3.	Cultural and language differences	12	8.5
4.	Difficult to get new network and customers	22	15.6
5.	Difficulties and uncertainties of making profit	53	37.6
	TOTAL	141	100%

TABLE 6: RESULTS OF CROSS TABULATION ANALYSIS

	Frequency
Industry	
Electrical & Electronics	11
Food & Beverage	39
Plastic Products	7
Rubber Products	6
Wood & Wood Products	15
Textile, Apparels & Leather	13
Healthcare	15
Others	3
Years of operations	
< 1 year	6
1 – 2 years	13
3 – 6 years	35
7 – 10 years	36
> 10 years	19
Employees	
< 5 people	11
5-50 people	17
51-99 people	49
100-150 people	32
> 150 people	-
NOTE: N = 109	

Cross tabulation analysis (Table 6) was conducted to look at the attributes of SMEs that involved in international business. Based on the industry, SMEs that produce food and beverage tops the list with 39 companies sell their product overseas. Next is wood and wood product together with healthcare product with 15 SMEs. In terms of years of operations, majority of these SMEs have been in business in between 3 to 10 years with a total of 71 companies. Analysis

even shows that majority of SMEs that internationalize have been in business for more than 3 years. In terms of employees, 49 SMEs that internationalize employs 51 to 99 employees, while another 32 have between 100 to 150 employees. Surprisingly, 11 SMEs were still able to internationalize even though they have less than 5 employees.

VI. CONCLUSIONS AND DIRECTIONS FOR FUTURE RESEARCH

This study indicates that the number of Malaysian SMEs that involved in international business activities is less (109) compared to those who did not (141). For those who do internationalize, increase in profit is the major reason behind their move. This is understandable as Malaysian market is very small and therefore, SMEs have to expand their market to gain more revenue. Finding is similar with Burpitt and Rondinelli's [30] study which shows that financial success motivates SMEs to internationalize in subsequent periods. To achieve this objective, SMEs use different methods and strategies when penetrating into foreign markets. Exporting seems to be the mostly used mode of entry as almost 75% out of 109 companies utilizes this method. SMEs are relatively small in their size and with their lack of resources. Therefore, exporting is indeed the most relevant mode of entry. Only small numbers of SMEs were able to use wholly owned subsidiary as this mode of foreign entry is the most expensive method of going abroad. This finding fits perfectly with the Uppsala model idea of exporting as the first step to enter an international market and it will serve as a platform for further international expansion using a more comprehensive mode of entry such as licensing, franchising or wholly owned subsidiary. The choice of exporting as the main entry mode may also be associated with the internationalization process of these SMEs as almost half of them indicates that they choose the careful, cautious and step by step approach when internationalize in order to avoid risk, followed by through network. However, there is quite a number of SMEs that goes for rapid expansion.

The important finding of this study is the fact that there is no single theory that can explain the internationalization of Malaysian SMEs. The Uppsala model, network approach and INVs or Born Global are still relevant in the context of Malaysian SME's internationalization. Even the Uppsala Model that has been criticized as not applicable in today's market environment is still valid as not all Malaysian SMEs that involved in international business are INVs or Born Global in nature. This study has found support for both the Uppsala model and the Network Approach as majority of SMEs in Malaysia still follow the same pattern suggested by both theories during internationalization. The fact that there are SMEs in Malaysia that goes for rapid internationalization shows that some SMEs are well equipped in terms of knowledge, financial and other resources needed in order to become an international company from the start.

This study contributes in a way that it provides the important information for government agencies, policy makers, managers and researchers by highlighting a number

of key issues that affect Malaysian SME's future international expansion in the global market. The fact that there is higher numbers of SMEs that did not involve in international trade shows that there are still opportunities for the government to encourage internationalization. A more comprehensive approach is needed to help these SMEs improve their competitive advantage by providing easier access to financing facilities, more assistance from relevant government agencies such as the Ministry of International Trade and Investment (MITI) and Malaysian External Trade Corporation (MATRADE), and make available a good quality infrastructure that supports the logistical aspect of internationalization. Managers of SMEs itself as indicated by previous discussions on INVs/Born Global theory, must equipped themselves with relevant knowledge and skills, be adaptive in the use of information technology and improve their operations and productive capabilities especially if they want to go for rapid expansion.

Finally, there are many possibilities for further research in SMEs internationalization. Future study may consider investigating the relationship between SMEs demographic characteristics and the internationalization process. There could be some common factors that indicate why SMEs internationalized either in stage, through network or from its inception. Future study may also look at the internationalization process of SMEs in different industries, especially the service sector (including ICT and Primary Agriculture). Moreover, it would be a good idea to investigate the influences of government policy, culture and many other factors as a mediator or moderator variable during internationalization process.

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