

# **MANAGEMENT & ACCOUNTING REVIEW**

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## Firm's Readiness for Internationalization

Herwina Rosnan<sup>a</sup>, Nuraisyah Chua Abdullah<sup>a</sup>,  
Norzayana Yusof<sup>a</sup> and Muhammad Syukri Abdullah<sup>a</sup>

<sup>a</sup>Universiti Teknologi MARA, Malaysia

### ABSTRACT

*This study addresses primary issues on internationalisation readiness among Small and Medium Enterprises (SMEs). Four factors namely foreign distribution, foreign marketing, foreign network and entry strategy are examined to help in enhancing the understanding on readiness for internationalization among SMEs. The main purpose of this paper is to examine the impact of these exogenous variables on readiness for internationalization among SMEs in Malaysia. The methodology utilized primary data from questionnaires which were administered to a sample of 190 SMEs in Malaysia. These self-administered questionnaires were distributed using the purposive sampling technique. Descriptive statistics, Internal Consistency - Composite Reliability (CR), Indicator Reliability – Indicator Loadings, Average Variance Extracted (AVE) (Convergent Validity), Fornell Larcker Criterion Discriminant Validity), Standard Beta, T-value, Effect Size ( $f^2$ ) and R Square were employed. Analysis used the Smart Partial Least Square (SmartPLS) path model. The results show that all factors were significantly correlated to Readiness for Internationalization. Further, this paper offers discussions and conclusions.*

**Keywords:** *Readiness, Internationalization, SMEs, Smart PLS*

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## INTRODUCTION

Internationalisation is defined as a process where firms take up international business activities (Cavusgil, 1980) whereby it integrates international, intercultural and global dimensions in product delivery (Knight, 2015). Hamidizadeh and Zargaranyazd (2014) defined internalization readiness as a “*firm’s preparedness and propensity to commence export activities overseas*”. Internationalisation has received tremendous attention from scholars such as Johanson and Vahlne (2009), Cavusgil (1980) and Tan, Brewer, and Liesch (2008). While firms’ attentiveness has direct linkages to the success of their internationalisation, there is a notable gap in the presence of a comprehensive internationalisation readiness model because there are relatively less studies which have addressed international preparation (Hamidizadeh & Zargaranyazd, 2014). Nevertheless, this paper has empirically constructed an internationalization readiness model that addresses the research aim of examining the effects of the exogenous variables on SMEs readiness for internationalization. Hence, the model consists of four variables that determine firms’ readiness for internationalisation. Those are foreign distribution, foreign marketing, foreign network and entry strategy. A detailed explanation of each variable is provided in the following section.

## LITERATURE REVIEW

### Foreign Distribution

The first variable affecting firms’ internationalization readiness is foreign distribution channels. It is regarded as an important factor for seamless exportation and sales in the international market in terms of being able to answer to the demand as well as increasing profits and market share (Ventorini, 2004). Distribution channels involve a set of interdependent organizations from one country, in the process of making a product or service available for consumption in another. As SMEs are well-known to be having limited resources compared to multinational firms, establishing a relationship with foreign distributors is vital. This is so because paying commitment to the relationship will lead to the ability of firms to learn, evaluate and exploit opportunities in foreign markets (Ismail, Isa, Alam,

& Ahmad, 2017). Therefore, it is proposed that SMEs would need to have foreign distribution channels as part of their requirements of being prepared to go international.

## **Foreign Marketing**

Generally, marketing strategy is delineated as firms respond to competitive market conditions. Although SMEs' foreign marketing is largely moderated by competitive intensity in the foreign market (Martin & Javalgi, 2016) it is undeniable that this aspect is positively influencing firms' efficiency and differentiation in the export market (Kaleka & Morgan, 2017). A considerable attention has been given in the literature to the relationship between marketing strategy and performance (Christensen, 1987; Da Rocha & Christensen, 1994; Koh & Robicheaux, 1988). In detail, foreign marketing such as market concentration and segmentation, product adaptation, price adjustment and trade fairs, among others, positively influence firms' export performance (Leonidou, Katsikeas, & Samiee, 2002). Hence, it is seen that foreign marketing plays a huge role in determining the preparedness of firms to venture into the international market. Nevertheless, lack of market knowledge (Johanson & Vahlne, 2009) and foreign marketing networks (Ciravegna, Lopez, & Kundu, 2014) can reduce the possibility of successful internationalization. This leads to the discussion of the third factor of internationalization readiness as explained below.

## **Foreign Network**

The importance of this aspect in helping SMEs to penetrate the foreign market and recompense for entrepreneurs' lack of knowledge has been documented numerously (Ciravegna et al., 2014; Narooz & Child, 2017; Odlin & Benson-Rea, 2017). In detail, foreign network assists in bridging structural holes, a situation where even indirect connection between firms are weak. Hence, having linkages between various parties in firms' supply chain would cover any loophole thus avoiding information asymmetry (Odlin Benson-Rea, 2017). It is argued that network-based advantages are more important than ownership advantages (Manev & Manolova, 2010) because social networks stand as a fundamental source of competitive strategy (Odlin & Benson-Rea, 2017). This would link firms' competitive advantage to their survival and growth in the international market. It

can occur through client-supplier relationships, personal and fortuitous contacts and network-building activities (Ciravegna et al., 2014). The process should happen prior to developing the activities abroad (Johanson & Vahlne, 2009) because it enables SMEs to access critical information and opportunities in foreign markets. Therefore, having various ways in creating networks help SMEs to gain knowledge and experience in foreign markets which would positively affect their readiness for internationalization. The following section provides a discussion on entry strategy as a part of firm's internationalization readiness.

## **Entry Strategy**

Entry strategy is defined as finding a suitable business structure when firms enter a foreign market, to effectively manage their overseas activities (Laufs & Schwens, 2014). Generally, there are two entry modes which are equity and non-equity. The former pertains to direct investment in the host country such as joint ventures and wholly-owned subsidiaries. Meanwhile, the latter is inclusive of direct and indirect exports, contractual agreements and sales office (Hollender, Zapkau, & Schwens, 2017). While the former requires more information gathering and processing due to its higher complexity, the latter is the opposite. Nevertheless, this does not negate the importance of entry strategy to the non-equity SMEs because future changes would incur a huge loss of time and money (Golbatenmofrad & Zhou, 2017; Hollender et al., 2017). Both strategies are bound to consider several contextual aspects such as SMEs home/host market, psychic distance, industry, and firm age as a guideline in selecting the best entry strategy. Specifically, home/host market revolves around the challenges and opportunities waiting in both locations. Psychic distance is the differences in home and host countries including cultural, political, economic and legal that would inhibit the information flow in the business. Industry is described as the characteristics shaping the competitive strategy of a group of firms producing similar products to one another. Meanwhile, firm age is a situation whether firms go internalise at inception (born global or international new venture) or incrementally. Due to the prominent effects of firms' choice of entry strategy, this aspect is an essential variable as the determinant of SMEs firms' readiness for internationalization.

## Hypotheses Development

As the variables of readiness for internationalization are explained, this paper proposes four hypotheses which consist of:

- H1: Foreign Distribution influences Internationalization Readiness
- H2: Foreign Marketing influences Internationalization Readiness
- H3: Foreign Network influences Internationalization Readiness
- H4: Entry Strategy influences Internationalization Readiness

## RESEARCH METHODOLOGY

This paper adopted a quantitative approach and the data was analysed using the Smart Partial Least Square (SmartPLS) software. PLS was considered appropriate (Roldan & Sanchez-Franco, 2012) as the focus was on the prediction of the dependent variable and to see the relationship between the independent variable and the dependent variable, A self-administered questionnaire survey on SMEs was used as an instrument to measure all variables. A 5-point Likert scale ranging from 'strongly disagree' to 'strongly agree' was used to measure the variables in this study. The survey items were designed to assess the dependent variable, Internationalization Readiness, adopted from Department of State Development Business and Innovation (2013) by using six items. Meanwhile, the independent variables; Perceptions of Foreign Distributing (three items), Foreign Marketing (four items), Foreign Network (four items) and Entry Strategy (four items) were also measured using the same source. The sample size was determined based on the G\*Power 3.1.9.2 software and the number of minimum sample size determined by this software is 90. This is an exploratory study which employed the non-probability convenience sampling. A total of 200 questionnaires were distributed and 190 were returned. This study follows the recommended two stage analytical procedures by Hair, Hult, Ringle, and Sarstedt (2014). First, it is suggested that after the research model was formed, researchers must test the outer model which is also known as the measurement model to ascertain the measurement items' validity and reliability. Second, the examination of the structural model (hypothesized relationship) is also recommended to test the significance of the path coefficients and the loadings a bootstrapping method.

## DISCUSSION AND ANALYSIS

Out of 190 respondents, 180 were from small- sized companies that accounted 96.15% of the total respondents. Meanwhile, another 6 and 4 respondents were from micro-and medium-sized respectively. We identified key informants who wanted to cooperate in this study and they have been acknowledged on the subject matter. Most informants were from the executive level of 75.79%, followed by export managers 17.37% and senior managers 6.84 %. Most them hold a bachelor’s degree.

**Table 1: Measurement Model Analysis**

Constructs	Items	Loadings	Composite Reliability	Average variance Extracted
	IR1	0.864		
	IR2	0.883		
Internationalization Readiness	IR3	0.878	0.846	0.790
	IR4	0.726		
	IR5	0.870		
	IR6	0.866		
	FD1	0.868		
Foreign Distribution	FD2	0.827	0.823	0.771
	FD3	0.742		
	FM1	0.871		
Foreign Marketing	FM2	0.831	0.861	0.803
	FM3	0.851		
	FM4	0.882		
	FN1	0.877		
Foreign Network	FN2	0.786	0.817	0.762
	FN3	0.779		
	FN4	0.724		
	ES1	0.779		
Entry Strategy	ES2	0.886		
	ES3	0.787	0.824	0.796
	ES4	0.882		



Indicator reliability of the measurement model was measured by examining the items loadings. A measurement model is said to have satisfactory indicator reliability when each item's loading is at least 0.700. Based on the analysis, all items in the measurement model exhibited loadings exceeding 0.700; ranging from a lower value of 0.724 to a higher value of 0.924. Based on the results, all items have demonstrated a satisfactory indicator reliability. Then, the measurement model's convergent validity was assessed by examining its average variance extracted (AVE) value. Convergent validity is adequate when constructs have an average variance extracted (AVE) value of at least 0.5 or more. As shown in Table 1, all constructs have AVE ranging from 0.762 to 0.803, which exceeded the recommended threshold value of 0.500. This result shows that the study's measurement model has demonstrated an adequate convergent validity.

**Table 2: Measurement Model - Assessment of Discriminant Validity based on Fornell and Larker's Criterion**

<b>Constructs</b>		<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
1.	Internationalization Readiness	0.813				
2.	Foreign Distribution	0.803	0.857			
3.	Foreign Marketing	0.791	0.850	0.861		
4.	Foreign Network	0.782	0.764	0.818	0.823	
5.	Entry Strategy	0.780	0.778	0.803	0.811	0.863

The bolded elements in the above table represent the square roots of the AVE which is known as the Fornell and Larker's value. The assessment of the discriminant validity is based on the Fornell and Larker's criterion. The non-bold values represent the intercorrelation value between constructs. Based on the results, all off-diagonal elements are lower than square roots of AVE (bolded on the diagonal). Hence, the result confirmed that the Fornell and Larker's criterion or discriminant validity is met.

**Table 3: Structural Model Analysis - Hypothesis Testing**

Hypothesis	Relationship	Std. Beta	t-value	Decision	f2	R2
						0.679
H1	Foreign Distribution	0.322	3.138**	Supported	0.080	
	□Internationalization					
	Readiness					
H2	Foreign Marketing	0.316	3.114**	Supported	0.074	
	□Internationalization					
	Readiness					
	Foreign Network □					
H3	Internationalization	0.285	2.593**	Supported	0.065	
	Readiness					
	Entry Strategy □					
H4	Internationalization	0.335	3.296**	Supported	0.087	
	Readiness					

To validate the proposed hypotheses and the structural model, the path coefficient between two latent variables was assessed. Based on previous studies, the path coefficient value needs to be at least 0.1 to account for a certain impact within the model (Hair et al., 2014; Wetzels, Odekerken-Schröder, & Van Oppen, 2009). The analysis shows that internationalization readiness is influenced directly by foreign distribution ( $\beta=0.322$ ,  $t=3.318$ ). As a result, hypothesis H1 is supported. Zilber, Junior, and Silva (2010) also found that foreign distribution significantly correlated to internationalization readiness. Foreign distribution is a very important element to ensure the success of internationalization activities overseas. Other than that, to test the structural model of foreign distribution and internationalization readiness by using the value of  $f^2$ , the value of  $f^2$  was used as a measure to determine the effect size of the variable in the model (i.e., 0.02 (weak), 0.15 (medium) and 0.35 (large) (Hair et al., 2014). The result of testing the effect size ( $f^2$ ) for the interaction between foreign distribution and internationalization readiness showed that it had a  $f^2$  value 0.080 lower than 0.15 (Hair et al., 2014), indicating that it had small effect.

The analysis also shows that internationalization readiness is directly influenced by foreign marketing ( $\beta=0.316$ ,  $t=3.114$ ). Hence, hypothesis H2 is supported. Foreign marketing and internationalization readiness was also found correlated in Wiktor (2014). To test the structural model of foreign

marketing and internationalization readiness by using the value of  $f^2$ , the value of  $f^2$  was used as a measure to determine the effect size of the variable in the model (i.e., 0.02 (weak), 0.15 (medium) and 0.35 (large) (Hair et al., 2014). The result of testing the effect size ( $f^2$ ) for the interaction between foreign marketing and internationalization readiness showed that it had a  $f^2$  value 0.074 lower than 0.15 (Hair et al., 2014), indicating that it had a small effect. Moreover, the study shows that internationalization readiness is directly influenced by foreign networks ( $\beta=0.285$ ,  $t=2.593$ ) thus supporting hypothesis H3. Jeong (2016) found that foreign networks had a significant relationship with internationalization readiness. The study explained various types of foreign networks playing an important role to ensure the success of internationalization performance. Further, to test the structural model of foreign networks and internationalization readiness by using the value of  $f^2$ , the value of  $f^2$  was used as a measure to determine the effect size of the variable in the model (i.e., 0.02 (weak), 0.15 (medium) and 0.35 (large) (Hair et al., 2014). The result of testing the effect size ( $f^2$ ) for the interaction between foreign network and internationalization readiness showed that it had a  $f^2$  value 0.065 lower than 0.15 (Hair et al., 2014), indicating that it had small effect.

Apart from that, entry strategy directly influences internationalization readiness ( $\beta=0.335$ ,  $t=3.296$ ) thus supporting H4. Similar to Dawei (2008), entry strategy is a vital element for internationalization activities and it is significantly correlated to internationalization readiness in Chinese firms. To test the structural model of entry strategy and internationalization readiness by using the value of  $f^2$ , the value of  $f^2$  was used as a measure to determine the effect size of the variable in the model (i.e., 0.02 (weak), 0.15 (medium) and 0.35 (large) (Hair et al., 2014). The result of testing the effect size ( $f^2$ ) for the interaction between entry strategy and internationalization readiness showed that it had a  $f^2$  value 0.087 lower than 0.15 (Hair et al., 2014), indicating that it had a small effect. The above table discusses the tests used to assess the validity of the structural model for this study. The  $R^2$  value indicates that the amount of variance in the dependent variable that is explained by the independent variables. Thus, a larger  $R^2$  value increases the predictive ability of the structural model. Referring to the table above, foreign distribution, foreign marketing, foreign network and entry strategy can explain 67.9% of the variance in internationalization readiness (IR).

## CONCLUSION

The contribution of SMEs in Malaysia is instrumental as they contribute to exports, employment and gross domestic product (GDP). Measuring readiness for internationalization is important in order to accelerate the contribution of SMEs to the economy. This study examined four factors namely foreign distributing, foreign marketing, foreign network and entry strategy in order to enhance the understanding on internationalization readiness among SMEs. The results indicate that all factors influence the readiness for internationalization. There are significant relationships between foreign distributing, foreign marketing, foreign network and entry strategy and internationalization readiness. All these independent variables are important elements. This study will help existing SME companies in expanding their business activities and revealing their differential roles on internationalization readiness of Malaysian SMEs.

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