

Dynamic Capabilities and Internationalization Level of Small and Medium Enterprises: Conceptual Model

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Abstract

Research on the internationalization of Small and Medium Enterprises (SMEs) has flourished due to its fundamental role in economic development. However, there is a lack of research on assessing the factors which influence internationalization level of SMEs. This research argues that dynamic capabilities possessed by SMEs' owners/managers are significantly associated with the internationalization level of SMEs. The most common entry mode for SMEs is exporting, hence this paper uses geographic scope (number of export destinations) as the suggested measurement for SMEs' level of internationalization. This study builds on the categorization of dynamic capabilities presented by Teece (2007) into sensing, seizing and reconfiguring capabilities and level of SMEs internationalization. The proposed model and hypotheses development were based on a review and synthesis of relevant academic literature. This paper ends by identifying a set of conclusions and areas of further research.

Key words: dynamic capabilities, level of internationalization, geographic scope and SMEs

Introduction

While most research concerning internationalization has focused on large and multinational corporations (MNCs), this issue has become increasingly important for SMEs (Filatotchev, Liu, Buck and Wright 2009). Research on assessing firm internationalization level was dominated the multinational firms, which are typically very large, employing several thousand people in various countries (Gubik & Bartha 2014). But internationalization is no longer confined to larger, multinational firms. The issue of possessing and maintaining the dynamic capabilities of SMEs owners/ managers, in particular those who are active in international market has attracted the attention of policy makers, academics and business professionals as well.

The extant literature reveals that SME's internationalization is linked with direct but unobservable owner/manager and firm-based factors which are dependent to dynamic capabilities (Zahra et.al 2005). SMEs need to possess capabilities to acquire external knowledge and disseminate it in order to respond faster to the market (Liao.et.al., 2009). This research is guided by the idea that in SMEs the role of the (dominant) entrepreneur is fundamental and that their possibility to respond to environmental changes is associated with the capability of entrepreneurs to recognize and exploit international business opportunities. In this vein, Teece (2007) argues that sensing, seizing and reconfiguring capacities arise in chronological order: the firm should sense and shape opportunity, then the firm's management should

make a decision by evaluating the opportunity followed by implementing the decision and when needed, adapted to the environmental changes. Such conceptualisation seems to be logical to explain the internationalization of SMEs.

Theoretical Background

Dynamic capabilities view was introduced by Teece, Pisano and Shuen (1997) as an extension of the Resource Based View (RBV) that encountered an increasing criticism for emphasising achievement of gaining competitive advantage only in static environment as stated by Eisenhardt and Martin (2000). Hence, dynamic capabilities are proposed to explain why some firms possess more sustainable competitive advantage than others within dynamic markets (Priem and Butler 2001).

Recognising the uncertainty and dynamism of business environment driven by rapid developments in communication and information technology, trade liberalisation, trade-related support services, cross-border capital flows (Koh et al 2009), internationalised SMEs need to possess dynamic capabilities to adapt to the environment in order to survive and prosper (Gereffi 2001). Hence, firms that have the capability in all facets of competitive priorities (Koch, Eisend, and Petermann 2009) will survive in such a turbulent environment. In this context, SMEs' performance will increase when SMEs owners/managers have the ability to effectively capture the existing opportunities derived from positive environmental signals (Liao et al., 2009).

Dynamic Capabilities

Basically, the concept of dynamic capabilities is considered as a relatively new concept in strategic management field introduced by (Teece and Pisano 1994) in their seminal article "The Dynamic Capabilities of Firms: an Introduction". This concept has explained the creation of competitive advantage by private companies in which companies possessing dynamic capabilities are expected to successfully adapt to rapidly changing business environments. Later, Teece and his colleagues argued that dynamic capabilities are associated with achieving and sustaining competitive advantage (Teece et al 1997). The concept of dynamic capabilities derived from the resource based view of the firm and inherited many key concepts from this theory (Barney 1991). Dynamic capabilities were defined by Eisenhardt and Martin (2000) as basic processes represented by a set of organisational routines that enable firms to reconfigure their resources in responding to market change. Firms which lack dynamic capabilities may gain short-term benefits from their current resource configuration, which eventually may fail to meet market requirements in the long run (Teece 2007).

According to Teece (2007) there are three components of dynamic capability, which are the capabilities of sensing, siezing and configuring. Along the way, many dimensions have been incorporated into substantive capability (Aramand and Valliere, 2012), market responsiveness, learning, coordination and integration (Wang and Shi, 2011) and integrative capability (Jiang et al., 2015). Nonetheless, dynamic capability should refer to the capability which was introduced by Teece et al (1997) and Teece (2007). This is because of its uniqueness and difficulty in replicating. This capability is needed so that firms can adapt themselves with various customers and acquire opportunity technologies.

While the literature reveals that dynamic capabilities reside at different levels of organization, a great deal of the research effort has emphasised the organizational level only. From organizational perspective, Teece et al (1997) have defined dynamic capabilities as the firm's ability to integrate, build, and reconfigure internal and external competences to address rapidly changing environments. On the individual level, dynamic capabilities were defined as the manager's ability to renew, augment, and adapt competencies over time (Marcus and Anderson 2006). The recognition of the multidimensional nature of dynamic capabilities lead to accepting the fact that the concept should be studied at the individual, organizational and network levels of analysis (Rodenbach and Brettel 2012). However, some studies have recognized the importance of dynamic capabilities at the micro/individual level (Teece 2007). This research tends to extend this current level of analysis in dynamic capabilities by highlighting the sensing, seizing and reconfiguring capabilities at the individual level (SME's owner/manager).

Level of SME Internationalization

The international activity of SMEs has not only been increasing in recent decades, but many authors suggest that firms that are internationally more active perform better and grow faster (Siedschlag et al 2010). This research uses the internationalization definition set by Welch and Luostarinen (1988), who defined internationalization as the process of increasing involvement in international markets. Exporting, involvement in international cooperation, and foreign direct investment can all be forms of corporate-level internationalization. When comparing the degree of internationalization of several firms, researchers usually use indicator sets and indices to determine which company is more internationalised (Gubik & Bartha 2014). These indicator sets, and especially the indices, were typically developed for multinational enterprises. The classical internationalization indicators and indices cannot be used for SMEs because of the lack of foreign affiliates. As import and export are the most common forms of internationalization, the basic indicator is whether or not an SME engages at all in importing or exporting activities. According to (Gubik & Bartha 2014) the more sophisticated indicators of assessing internationalization levels include the intensity of exports (share of exports from the total sales of the company) and the geographical scope of exports (the number of countries/regions a company exports to).

The literature presents several measurements of firm level internationalisation. Gubik and Bartha (2014) developed a Small and Medium-Sized Enterprise Internationalization Index to measure the degree of internationalization in the SME sector which was calculated as an unweighted average of four components: Export intensity, Attitude of the owner/entrepreneur/manager, Geographical scope, Complexity of strategy. Dunning and Lundan (2008) identified a 7 criteria which have been generally used in the literature to assess the degree of an enterprise's internationality: the number and size of foreign affiliates; the number of countries in which the firm operates; the proportion of foreign assets, sales, income or employment of the firm; the internationalization of the ownership or management of the firm; the depth of foreign production; involvement in the control of international networks; and the extent to which responsibility in critical management issues (e.g. financial and marketing decisions) is devolved to foreign affiliates (Dunning & Lundan, 2008). Rugman (2007) used sales data to show the most of the largest multinationals from the Triad (Japan, Europe and North America) concentrate their activity on their "home" region. Cerrato and Piva (2012) employed four variables to measure the internationalization of Italian SMEs: 1) engaged in exports (yes-no); 2) export intensity, 3) geographical scope (number of regions the firm exports to; and sales based entropy index (combining the previous two). Based on the nature and attributes of SMEs, it is logical to assess their level of internationalization based on their geographic scope and number of export destination.

Exporting and Firm's Geographic Scope

More recently, empirical analysis has extended to consider the geographical scope of firms' internationalization, and in particular whether it is intra-or inter-regional. This arises from the suggestion that the costs of foreignness may differ across countries and across regions, with the liability of inter-regional foreignness being greater than that which occurs within global or 'triad' regions. While this issue has been principally studied at the level of the multinational enterprise (Driffield, Love, & Yang, 2014), the issue is also relevant to the internationalization of SMEs. If there is a greater cost of foreignness for firms operating in inter-regional markets, this may be a particular issue for SMEs which are generally regarded as lacking the internal resources of larger firms, and hence find it more difficult to operate in geographically, institutionally and culturally distant markets. Despite the potential importance of this topic, there is relatively little research in the area. There is some evidence that there are differences in the internal attributes of SMEs which operate across regional or global markets (Kuivalainen, Sundqvist & Servais 2012; Nkongolo-Bakenda, Anderson, Ito, & Garven 2010), and that the determinants of exporting performance among SMEs may differ depending on whether the firm is operating within its home region or across different global regions (D'Angelo et al., 2013). However, we still know little about how much experience matters in terms of helping SMEs enter new regional markets, and how this differs from the role of experience in shaping other aspects of SMEs' international profile.

Christopher et al (2018) investigated the perception of difficulties in the internationalization process of small and medium wineries in two emerging Italian wine exporting regions. It is found that the difficulties perceived in the internationalization process depend on strategic and structural factors: the degree of international

diversification and the geographic scope of a firm's export activities. The structural factors relate to the characteristics of the exported goods, the management and the size of a firm. Katsikeas (1996) found a number of significant differences between market concentration and market spreading strategies. Firms concentrating on a few markets tend to be smaller and exhibit a greater interest in export profitability, but are less concerned with export sales objectives. Visiting overseas markets is also more important in the export strategy of these firms. These market concentrators tend to have less favourable export market share expectations. This may be in part due to the fact that they have already gained a considerable share of the foreign markets they operate in. Market spreaders perceive fewer problems related to product adaptation, but faced more problems with the organization of their export marketing function and are less likely to sustain a competitive pricing advantage in overseas markets. In contrast, market spreaders are larger firms, attaching greater importance to sales volume objectives. These firms are more involved in export marketing research and have more favourable export market share expectations. At the same time, they place less emphasis on export profitability and are less concerned with personal visits to foreign markets. The length of firm experience in export markets and foreign operations did not significantly discriminate between the two export strategies. Relevant experiential knowledge is a prerequisite in the development of a successful export activity, regardless of the international market expansion strategy (Leo & Ku 2015). Recognizing the nature of SMEs, this research proposes geographic scope (number of export destinations) as the measure for SMEs level of internationalization.

Exporting is by definition a risk-taking activity, as the firm operates in an environment that is characterized by a certain degree of uncertainty. Therefore, firms need resources and competencies to successfully overcome obstacles to foreign development and to manage a process of international growth. SME exporting has already been studied in the RBV literature, but Knight and Cavusgil (2004) observe that little of this research focuses on small firms. Barney et al. (2011) appeal for studies that expose the RBV to different governance regimes besides the large MNEs that have been the focus of most of the exporting literature. Reuber and Fischer (2011) showed that experienced firms represent a resource that has a major part in the degree of internationalization of SMEs. Exporting of course requires the development of external and international ties, and Barney et al (2003) show that family ties hamper a firm's ability to develop other cross-border ties. Previous studies have underlined the importance of specialists to successfully manage foreign activities (George et al., 2005).

Dynamic Capabilities and Internationalization Level of SMEs

According to Li, Easterby-Smith and Hong (2018) dynamic capabilities are arguably of more value in firm internationalization process that operate in highly dynamic international markets. Li et al (2018) argued that there is a scarcity of research on the nature of dynamic capabilities in highly dynamic international markets. In their exploratory study, Li et al (2018) stated that dynamic capabilities of MNCs in high-velocity markets are analytic, strategically planned high-frequency processes and routines, dynamic capabilities are highly complicated, and they rely extensively on combined knowledge derived from global and local knowledge. Despite this significant attention, dynamic capabilities are still un-derappreciated

because their nature has not been adequately explored (Barrales-Molina, Bustinza, & Guti'errez-Guti'errez, 2013; Barreto, 2010; Dixon, Meyer, & Day, 2014).

Although some scholars (Mikalef & Pateli, 2017; Wilden & Gudergan, 2015) have argued that dynamic capabilities also exist in environments subject to lower rates of change, the possession of dynamic capabilities may be relevant only in fast-moving business environments (Barrales-Molina et al., 2013; Wilden & Gudergan, 2015). Manson et al (2018) examined the actual and expected relationship between dynamic capability, and export performance of Malaysian manufacturing SMEs. Their research findings revealed that sensing and adaptive capabilities have a significant impact on export performance with emphasis on the mediating role of international opportunity recognition.

Hypotheses Development

Based on Teece's (2007) categorization of dynamic capabilities and linking it with SMEs' level of internationalization, this paper proposes three hypotheses as illustrated in Figure 1:

Sensing Capabilities and SME's Level of Internationalization

Dynamic capabilities can be identified from the trajectory of organizations in a historical perspective, since its foundation, as a characteristic of accumulated knowledge dependence (Teece, Pisano, & Shuen, 1997). Teece (2007) defined sensing capability as the ability of firms to always scan, search and explore markets and technologies. Market information collection and analysis in a bid to explore about the customers, channel members and competitors, entails a process of sensing capability. It helps firms to learn and understand the market needs, competitor moves and technology, which in turn helps to easily identify possible opportunities (Pavlou and El Sawy, 2011).

Zhang and Wu (2013) agreed on the importance of sensing capability and added that it requires investment on specific activities to fulfil customer needs, obtain new technology and understand industry structure. Fang et al. (2014) supported the argument that with sensing capability, market can be monitored and opportunities rather than potential threat can be detected.

Wagner et al. (2017) defined sensing capability as the ability to sense customer preference and trends, and not to search and explore markets and technology. Online communication can act as a tool to learn customer preference and trends. Firms can collect relevant information and analyzes them when predicting viable trends in the market. In fact, we can also be made aware if there is any change in customer preference (Miocevic and Morgan, 2018). Wilden et al (2013) stated that having sensing capability, firms can get a head start over their competitors to sense a new market trend. Hence, dynamic capability can exist in a fiercely competitive environment, thus benefiting firms. They will be more innovative and an

exploration of new market and products ensues. Therefore, Macpherson et al. (2004) supported that sensing capability is indispensable to ensure firms' sustainability in a fiercely competitive market. This can be done through opportunity recognition activities.

H1: Sensing dynamic capabilities have significant impact on SMEs' level of internationalization.

Seizing Capabilities and SME's Level of Internationalization

In the context of seizing capabilities, Teece (2007) points out that the organization must establish: solutions for the consumer and their business model; decision-making protocols; commitment and efficient means of communication and dissemination of values; and organizational boundaries for complementary assets management and the control of platforms, creating an organizational structure that facilitates the seizing of opportunities.

While sensing dynamic capabilities secure access to external knowledge, seizing dynamic capabilities focus on the realization and exploitation of this knowledge. According to (Katkalo et al 2010) Seizing refers to the organizational strategy and infrastructure for making appropriate decisions and absorbing and integrating resources to create and capture value from addressing opportunities. In this context, the internationalization process itself can be seen as "a path a firm decides to follow in order to seize worldwide opportunities" as argued by (Prange and Verdier 2011).

Furthermore, (Harreld et al 2007; Teece 2007) argue that seizing dynamic capabilities pertain to creating new product or services as well as new business models which can transform recognised opportunities into valuable outcomes. More recently, (Teece 2011) stated that seizing capabilities involve securing access to capital and skilled human resources. This often demands forging new relations with customers, co-operators, suppliers and distributors. In order to seize opportunities, Barreto (2010) indicated that firms need to make timely as well as market-oriented decisions. Similarly, (Eisenhardt & Martin 2000) emphasized the propensity to make timely decisions indicating that there might be some potential for competitive advantage by acting "sooner" than competitors.

H2: Seizing dynamic capabilities have significant impact on SMEs' level of internationalization.

Reconfiguring Capabilities and SME's Level of Internationalization

Once opportunities are shaped and seized, reconfiguration capabilities are needed to exploit them. Reconfiguring capabilities involve the abilities to manage threats and to reconfigure assets and organizational structures in order to prevent inertia (Teece 2009). According to (Lee and Kelley 2008) reconfiguration activities encompass combining know-how within and outside the organisation, and enabling novel approaches for assembling and integrating resources. In addition, Teece (2009) indicated

that reconfiguring capabilities require establishing procedures for sharing and integrating knowledge in a collaborative surrounding as well as the creation of proper learning settings may be critical for transforming. Basically, dynamic capabilities are needed to link organisational internal resource configurations with the surrounding environment as stated by Teece et al (1997). Accordingly, we may argue that dynamic capabilities may contribute to clear identification of organizational internal strengths and weaknesses that lead to anticipating external opportunities and threats. In this vein, Lee, Lin, Kim and Shyr (2011) and Zahra et al (2006) advocated the significance of dynamic capabilities in allowing firms to identify and exploit opportunities. Similarly, (Teece 2007) stress the need for firms to search for, and explore relevant context aspects such as the market environment or the technology in which they are involved. On the other hand, Zott (2003) highlighted the need for firms to decide on potential alternative configurations of its resources and capabilities. According to Zott (2003) this activity is called variation.

In the scope of the last perspective of capabilities exposed by Teece (2007), it is highlighted in the results the aspects of governance and co-specialization and knowledge management, also related to the relation auto-maker/supplier. Hanohov and Baldacchino (2018) indicated that the adaptive capability means that firms always make changes in their products. Therefore, Teece (2012) stresses that entrepreneurs critically need to develop adaptive capability, especially for small firms that are natural entrepreneurs since this aspect of dynamic capability is market-focused, allowing a strong focus on market characteristics.

H3: Reconfiguring dynamic capabilities have significant impact on SMEs' level of internationalization.

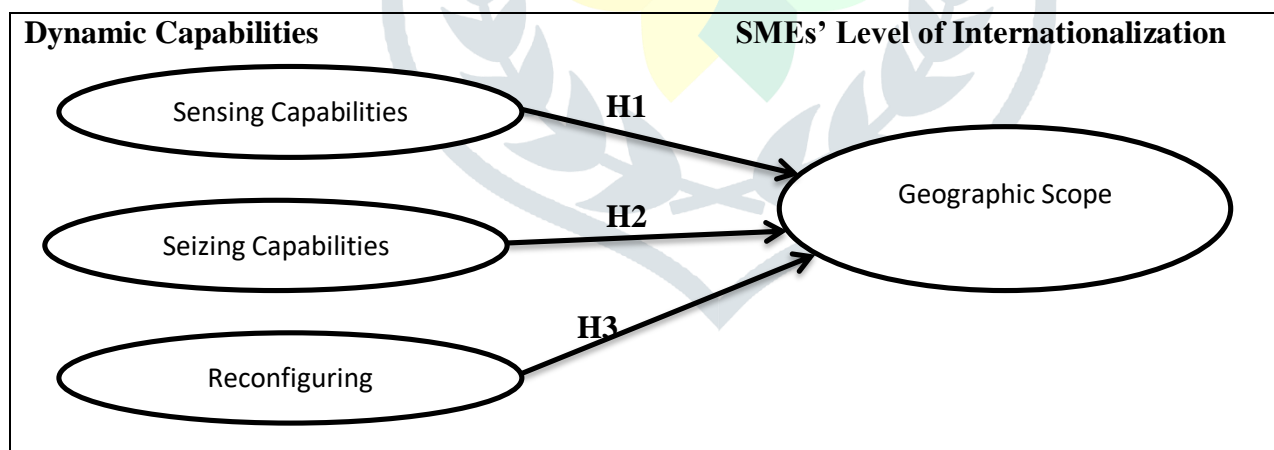


Fig 1: Proposed Conceptual Framework

Conclusion & Further Research

This paper has proposed a model to assess internationalization level of SMEs based on dynamic capabilities perspective. The basic assumptions of this research revolve around the dominant role of SME's owner/manager as the decision maker and investigating dynamic capabilities at the individual level. Guided by the nature of SMEs, the level of internationalization was represented by the geographic scope (number of export destination). The dynamic capabilities conceptualization presented by Teece (2007): sensing,

seizing and reconfiguring capabilities were suggested to assess the internationalization of SMEs. Further research may testify the proposed model using interviews or survey questionnaire to examine how dynamic capabilities enhance SMEs' level of internationalization.

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