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# Influence of Organizational Capabilities and Environmental Factors on Internationalization Strategy of SMEs

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## Abstract

The study discusses organizational capabilities in relation to entrepreneurial experience, innovation, networking and external environmental factors consisting of industry and market, international network relationship, international innovativeness and international market skill to explain internationalization of SMEs. The paper draws on theoretical push and pull framework to explain the constructs and present the intermediating factor between push and pull forces and internationalization of SMEs. The review of literature shows that international entrepreneurial orientation and export promotion program as intermediating variables in the model can increase or lessen the interactive forces of pull and push factors. The study discussed evidence of relationship between the research constructs and how the interactive forces influence the internationalization of SMEs.

**Keywords:** Organizational capabilities, external environmental factors, push and pull factors, internationalization of SMEs

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## 1. INTRODUCTION

Internationalization has become a global economic phenomenon in which scholars and practitioners have been conducting considerable research (Gacheri & Wepukhulu, 2015). SMEs internationalize to compete with bigger firms in international markets contributing significantly on economic growth by providing employment and development of domestic technology (Kunday & Şengüler, 2015). Internationalizing is extending business activities beyond national borders especially for firms that operate in domestic market. Panda & Reddy (2016) consider internationalization as expanding firm activities by involving international commitment of resource in more than one country. Three influences of internationalization of a firm can be identified; the environmental factors which include for example, distance, technology, country of origin, industry; secondly, firm level to include capabilities, strategic orientation, knowledge, liabilities; and lastly the managerial factors including mindset, company experience, entrepreneurial orientation (Swoboda & Olejnik, 2016; Kuivalainen, Sundqvist & Saarenketo 2012). There are studies at different levels of internationalization by researchers that focused on the factors motivating SMEs toward internationalization. Motivation to internationalize could be to search for market opportunities, risk reduction, access to financing, diversify business risk and in an effort to search for knowledge and learning (Ellis, 2010; Kontinen and Ojala, 2011). This study applies the integrative push and pull framework (Etemad, 2004), using antecedents from internal and external to firm, explained by various theories to test the internationalization of SMEs in Nigeria. This approach has been scarce in past studies on internationalization of SMEs (Martineau & Pastoriza, 2016).

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## **1.1 Problem Statements**

Martineau and Pastoriza (2016) reported that, past studies did not show evidence of integrating various antecedents from different theoretical perspective to explain the internationalization of SMEs and little is known on influences of environmental and organizational factors on internationalization decision of SMEs. This implies that studies combining antecedents from various theoretical perspectives to explain internationalization of SMEs are limited. Crick and Spence (2005) and Jones and Coviello (2005) believed that various theories must be integrated to give clearer understanding of contemporary international involvement. There are also limited studies in the internationalization of SMEs using antecedents that shows interaction of resources, namely industry and institution- based variables to determine how collectively they affect internationalization strategies (Gao, Murray, Kotabe, & Lu, 2010; Yamakawa et al., 2008). This indicates limited empirical research on the interaction between internal factors to the firm and external environment on how they influence internationalization strategy (Fangrong, 2013). Relationship between the use of export promotion program and export performance studies in literature is little due to lesser attention because research on how export performance is influenced by export assistance is few (Shamsuddoha et al., 2009). Sraha (2015) suggest that export promotion studies on developing countries of sub-Saharan African have been limited in the literature and in particular, export performance studies are scanty in Nigeria (Okpara & Koumbiadis, 2009; Junaidu 2012). On the basis of the gaps identified, the study intend to 1. Use multiple theories in the framework to explain the relationships. 2. Combining constructs from internal and external resources. 3. Determine how organizational capabilities and environmental factors influence internationalization. 4. Investigate how internationalization level is determined by selected factors from organization and environment. 5. To ascertain the extent of export growth with export promotion programs.

## **1.2 Research Questions**

1. What are the levels of internationalization of Small and Medium Enterprises in Nigeria?
2. Is there any relationship between organizational capabilities and internationalization of SMEs in Nigeria?
3. Is there any relationship between external environmental factors and internationalization of SMEs in Nigeria?
4. Does entrepreneurial orientation of firms mediates the relationship between organizational capabilities, environmental factors and internationalization process of SMEs in Nigeria?
5. Is there any moderating effect of the export programs on the relationship between international entrepreneurial orientation and internationalization of SMEs in Nigeria?

## **2. LITERATURE REVIEW**

Internationalization of small and medium sized enterprises (SMEs) is defined as increase involvement and commitment in transaction beyond the firm's national borders (Taylor, 2013). It is also been defined as the process of adopting a firm's operations involving its structure, strategy and resources to international environment (Calof & Beamisht, 1995). The increase involvement in the international market can be direct or indirect export, license/franchise, foreign direct investment, overseas subsidiary and international joint venture (Taylor, 2013). It has also been explained as business relationship with a foreign partners involving export, import, international technical co-operation, foreign direct investment (FDI) and international subcontracting (Daszkiewicz & Wach, 2012). Internationalization of small and medium sized enterprises has been of great interest especially to academics and practitioners due to the fact that the output of SMEs in international transaction have increased substantially in decades as a result of rapid development in information and communication technology, globalization and international trade (Kunday & Şengüler, 2015; Navarrete-hinojosa, Olea-miranda, Rodriguez-carvajal, & Duarte, 2016).

Changes caused by technology in social and economic system are the major factors that facilitate acceleration of the recent trend in SMEs internationalization (David, 2016). These developments change the ways SMEs conduct business worldwide by taking advantage of borderless world resulting from regional economic integration, policies of commercial openness, support by government and institutions as well as market liberalization ( Amorós, Ciravegna, Etchebarne, Felzensztein & Haar, 2015). The elimination of trade barriers and impact of technology enable small and medium sized enterprises to compete with multinational enterprises (MNEs) within and outside their home countries (Etemad, 2005). Lis & Mauch, (2012) believe that, liberalization of trade has a disadvantage of making possible a tense competition and market saturation but have greatly enhance SMEs competitiveness in the global market.

The process of internationalization of SMEs has been basically discussed from the following approaches; the internationalization theories which include Uppsala Model (Johanson & Vahlne, 1977, 2009), the International New Venture (Oviatt & McDougall, 2005) and Born Global (Knite & Cavusgil, 1996). While the Uppsala model

dwelling on slow and gradual process of involvement into foreign market, International New Venture (INV) and Born Global (BG) discusses why and how firms internationalized with a speed at early stages of their existence. These theories are based on big businesses and provide guidance for larger firms while small and medium enterprises lack theory to guide them through internationalization process (Etemad, 2004). Etemad (2004) therefore developed the following grounded theoretical framework the “integrative push and pull framework” as a guide to SMEs in achieving internationalization.

## 2.1 Push and Pull Integrative Framework

The theoretically grounded framework has three constructs; the Pushing Forces, the Attractive Pulling Incentives and the Mediating Forces of Internationalization. The pushing, pulling and intermediating interact in the SMEs’ internationalization process for a desired outcome.

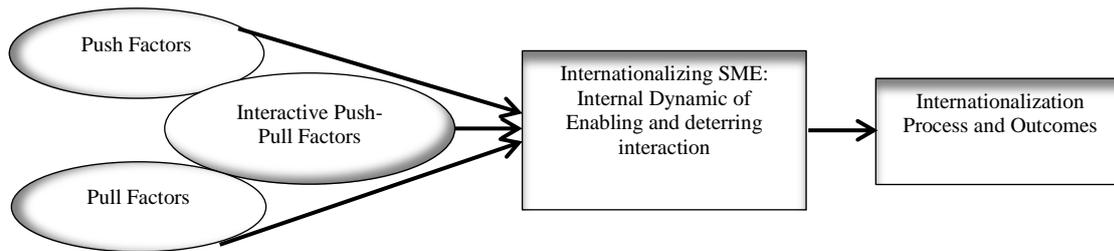


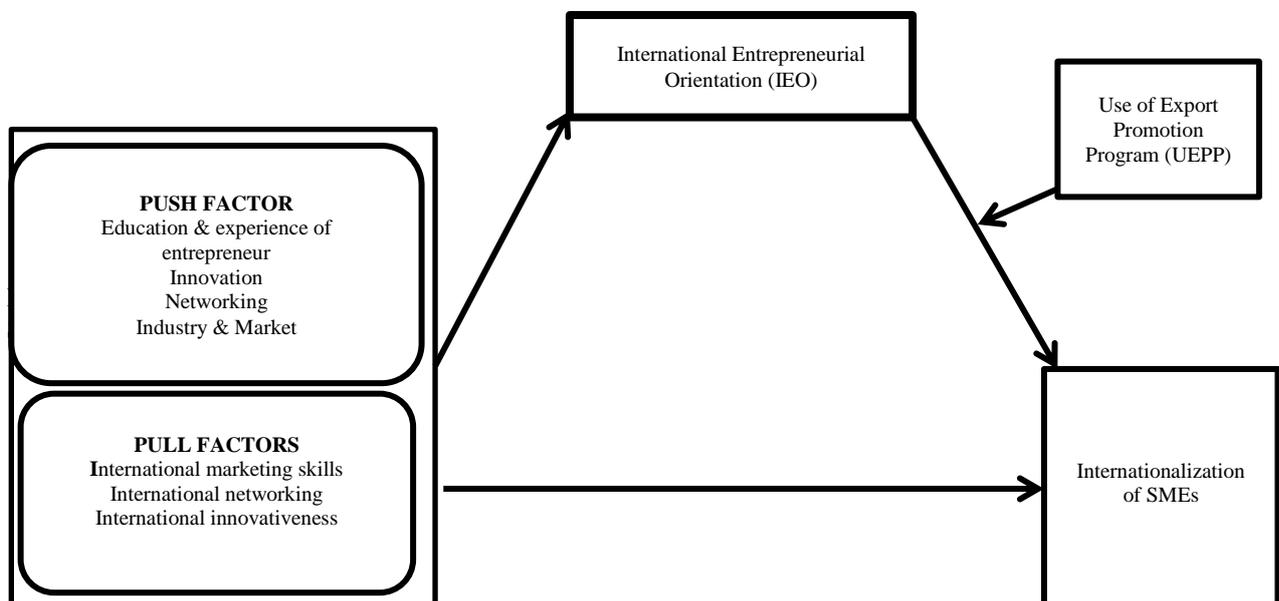
Fig. 1 Theoretical Push and Pull Framework

Source: Etemad (2004)

Having identified internationalization of SMEs and theoretical gaps, this paper applies Push and Pull framework (Etemad, 2004) to discuss the phenomenon and interrelationships between and among the constructs. The framework will be used to identify and explain how organizational capabilities and environmental factors as independent variables interact as “push and pull factors” to influence internationalization of SMEs through intermediation. The choice of the variable is in line with assertion that, where a literature review indicated a comprehensive list of potential factors that affect internationalization process (for example, Etemad, 2004) they are not all relevant in the study of early internationalization and therefore a research focusing on one specific country, domestic circumstances need to be taken into consideration (Nowiński, & Bakinowska, 2012). In choosing the variables for this study thus, literature on SME internationalization is taken into account and on that basis nine variables were identified that are expected to influence internationalization of SMEs in Nigeria.

## 3. FRAMEWORK AND HYPOTHESIS DEVELOPMENT

The framework contains set of forces. The independent variable consists of two set of construct; organizational capabilities and environmental factors, pushing and pulling the firm to internationalize. The mediator variable as entrepreneurial orientation and moderator variable as export promotion program have been discuss below, showing they relate to each other.



This part explains the relationships in the proposed research framework with the following constructs; independent variable consisting of organizational capabilities (international education and experience of an entrepreneur, innovation, and networking) and environmental factors (industry and market condition, international market skills, international network relation, and international innovativeness), mediating, moderating and dependent variables.

### **3.1 Relationship between Organizational capabilities and Internationalization of SMEs**

Scholars have reported that internationalization of SME is determined by resources that are internal to the organization. According to RBV, firms require those resources that cannot be easily substitutable, rare, unique and inimitable to compete favourably in international market (Barney 1991). These resources constitute firms' capabilities and are strategic to internationalization. Firm's internal capabilities have been found to be related to firm performance and internationalization. Disruption and consolidation capabilities (Pinho, & Prange, 2016), capability in entrepreneurial intensity (Urban, & Sefalafala, 2015), capabilities in entrepreneurial orientation and networking (Ajayi, 2016) have been found to be positively related to internationalization and firm performance. Capabilities in technology also have been every strategic to achieving internationalization, example speediness of information and communication technology (Hernández, Hualde, Mulder, & Sauv e, 2016), innovative process that is based on knowledge and technology of external suppliers, and innovative firms are better equip for international market opportunity than non-innovative firms (O'Casey, & Weerawardena, 2009) have a positive relationship with internationalization of firms. RBV further suggest that, internal capabilities and opportunities from market determine the direction of international growth of the firm (Andersen 2010) which in turn enhances international performance. Based on these assertions, the following hypothesis is formulated:

H1: Organizational capabilities are positively related to internationalization of SMEs

### **5.2 Relationship between Environmental factors and internationalization of SMEs**

Business operating environment consist of constraints and opportunities that are very crucial to internationalization success. Businesses have little or no influence on these factors, they can only be responded to by the firms' capabilities and strategies (Etemad, 2004). Institutional theory stresses the effect of the systems around the organization that shape the behaviour of the organizations and their decision making process (Bruton, Ahlstrom & Li, 2010). Institutions are constraints made by human that organize human interaction both formal and informal. Institutional forces from economic perspective influence business activities in a country especially at macro-level. This is done through provision of facilities to enhance efficient economic transaction, like legal and regulatory system in a country. The actions of institutions include economic, social, political perspectives, technology and determination of transaction costs, thereby making influence on business activity in a country (Bruton, Ahlstrom & Li, 2010). The role of economic perspective is encouraging interaction of firms and institution to reduce cost of transaction and information as well as uncertainty. Behaviour of firms is determine to greater extent by resource and industrial factors if there is well developed macro-institutional framework that supports market-based dealings (Fangrong, 2013). Firms adopt strategies in response to the transaction cost structure made by macro-institutional environment by doing this, efficiency and performance will be enhanced. Based on this, the following hypothesis is stated:

H2: Environmental factors are positively related to internationalization of SMEs

Previous studies insist that internationalization should be discussed using several relevant theories (Crick & Spence, 2005; Jones & Cavello, 2005) therefore using linear model to explain the internationalization process of a firm as proposed by U-Model which take into consideration foreign experiential knowledge and networking only (Johanson and Vahlne, 2009) has been criticized (De Villa, Rajwani & Lawton 2015). This study therefore intends to include dimensions of independent variables (Entrepreneurial education and experience, innovation, networking, industry and market, international innovativeness, international market skills and international networking), international entrepreneurial orientation and export promotion program as mediator and moderator respectively. Various theories will be used to explain the components of the predictor and intermediation variables. From the above position, the following hypothesis is proposed;

H3: Organizational Capabilities and External Environmental factors explain the variation in internationalization of SMEs

### **5.3 Relationship between International Entrepreneurial Orientation, Organization Capabilities, Environmental factors and internationalization of SMEs**

Entrepreneurial orientation has been a strategic factor in achieving performance in international new venture (INV), and INV over time is identified by its strong entrepreneurial orientation through manifestation of innovativeness, pro-activeness and risk taking approach beyond national borders (Cavusgil & Knight, 2015;

Martin, Raj, & Javalgi, 2016)). International entrepreneurship literature has acknowledge widely that the survival and growth of INVs is related to entrepreneurial orientation (Kocak and Abimbola 2009; Wiklund and Shepherd 2005). From the literature EO has been referred to as process of strategy making which is the organizations' basis for decisions and action in entrepreneurial journey (Wiklund and Shepherd 2005).

However, previous studies have shown variations in the relationship between EO and performance, revealing inconsistency in the empirical findings. The strength of the relationship differs across studies for example; it was found that there is better performance by firms that strongly adopt EO than the businesses that do not adopt (Hult et al., 2003; Lee et al., 2011; Wiklund and Shepherd, 2003). But some studies on contrary have indicated lower correlations between EO and performance (Dimitratos et al., 2004; Lumpkin and Dess 2001; Zahra and George, 2002) or no significant relationship between EO and performance (George et al., 2001; Wiklund and Shepherd 2005). Other results that showed inconsistent findings are for example; only innovative activity was significantly effective on the performance of international new ventures while pro activeness and risk taking were not significant (Kropp et al., 2006). It was further found in another study that there is a negative effect of actions that are risk oriented while significant relationship was found between proactive behaviour with only sales growth (Andersen, 2010). Hence, these conflicting relationship between EO and business performance show considerable variation that exist in the literature of IE and this can constitute resource constraints on INV which means, there is need for them to develop more capabilities to overcome those weaknesses.

Meliá, Blesa & Dobón, (2010). In study conducted in Spain found a positive relationship between innovative orientation and internationalization. This was evident by how firms with innovative orientation take less time in internationalization and have high control of foreign market entry mode. Ibeh (2003) conclude that international planning orientation is a driver in enhancing export performance. In other studies, it was found that effective strategic decision to enter international market is associated with EO, and high export oriented entrepreneurs were found to be exporters than those with low export orientation (Okpara, & Koumbiadis, 2011). Okapara (2016) asserts that, firms that adopt proactive orientation attain higher performance and growth than conservative firms. Similarly, Ajayi (2016) revealed a strong positive association between entrepreneurial orientation and export performance in Agricultural SMEs. Base on the empirical evidence above, the following hypothesis is here by stated;

H4: International Entrepreneurial orientation mediates the relationship between Organizational Capabilities, Environmental factors and Internationalization of SMEs

#### **5.4 Relationship between Export Promotion Program, International Entrepreneurial Orientation and internationalization of SMEs**

Export promotion programs (EPPs) are measures undertaken by government to offer assistance to firms in their effort in exporting activities (Shamsuddoha, 2006). The application of export promotion programs helps firm improves the capabilities and resources required to manage export operations (Leonidou, Palihawadana & Theodosiou 2011). Managers' level of perception explains their awareness of exogenous environmental influence, threat and opportunities of international market and how to respond to them. The export knowledge of a manager is his level of foreign market knowledge, exporting procedures and government export regulations (Shamsuddoha, 2006). In control economies, institutions play a crucial role in the internationalization process of firms (Wright, Filatotchev, Hoskisson, & Peng, 2005; Peng, Sun, Pinkham, & Chen, 2009) by providing resources to enable them compete in the foreign market, Fangrong (2013).

The institutional theory provides that government agencies are supportive to firms by engaging them in programs such as EPPs that enhance firms' performance in internationalization and economically, the justification for involvement government in export promotion is explained by theory of externalities and market failures related to export (Kanda, Mejía-Dugand & Hjelm, 2015; Lederman et al., 2010). Market failures explains condition in which there is failure of free market to allocate resources efficiently to ensure effective production and consumption in the market and internationalization theory (Johanson and Vahlne, 2009) that getting into international market involve slow and incremental knowledge and experience, then gradually increase commitment to international market. The resources are mainly limited with small firms compared to larger once. These resources for firms' competitive advantage according to resource base view (RBV) are valuable, rare, inimitable and cannot be substituted easily (Barney 1991) therefore, external source such as government export promotion programs can be a means for firms to acquire such resources (Katsikeas, Piercy, and Ioannidis 1996).

Empirical studies have indicated that external environmental conditions become an opportunity and/or threat which moderates the ability of a firm to be competitive in international market (Omar, 2009; Rialp et al., 2005). Other studies also found environmental uncertainty to be negatively related to international performance of a firm,

thus, entrepreneurial performance relationship is affected by environmental condition (Child et al., 2003; Zhou et al., 2007a). There have also been consistently a moderator effect of environmental difficulty between entrepreneurial orientation and SMEs success from developing countries (Frese et al., 2002), and what essentially causes lack of incentive for the SMEs export performance in developing countries is business environment with unstable political climate, poor government policy framework, poor state of local infrastructure, low technological level and country's bad image abroad (Taylor, 2013). Similarly, Zahra and George (2002) found environmental factors as moderators that explain the international behaviour of a firm. They opined that, environmental condition varies and can be favourable or unfavourable to SMEs and entrepreneurship. EPPs have been found to have direct effect on firm export performance and indirectly through knowledge acquisition and commitment making (Shamsuddoha, 2006). Leonidou, Paliawadana, & Theodosiou, (2011) in the study of national export promotion program as drivers of organizational resources reveals that firm's export-related capabilities and resources is positively affected by adoption of national export-promotion programs which subsequently enhanced effective export strategy. Leonidou, Paliawadana & Theodosiou (2011) found a positive relationship between export promotion program and firms' resources and capabilities that are export-related. Their result also revealed stronger effect of export promotion programs on smaller firms and among less export experience firm in some programs. Going by the above assertion, the researcher believes that, use of EPPs will add and enhance the strength to the mediation effect of IEO on the internationalization of SMEs, hence the formation of the following hypothesis;  
H5: Export Promotion Program moderates the mediating effect of IEO on Internationalization of SMEs

## **6. CONCLUSION AND IMPLICATION**

The study discusses organizational capabilities and external environmental factors. Previous studies have indicated that organizational capabilities have significant effect on internationalization success; education level of an entrepreneur (Paw, 2015), innovation ((Moshood, Nassar, & Faloye, 2015; Madrid-Guijarro, Garcia & Auken, 2009; Tulus, 2011), Networking (Amorós, Ciravegna, Etchebarne, Felzensztein, & Haar, 2015), and home market can push a firm to internationalize as a result of product demand decline, idle production capacity and especially if the foreign market is growing (Rymarczyk 2004). Similarly the skills that affect external commitment of the firm have also shown effective role in internationalization of SMEs; international network relationship (Bruton et al., 2010), International marketing skills (Knight & Kim 2009), International innovativeness (Knight, Kim & Knight, 2015). International Entrepreneurial Orientation (IEO) influence and support international entrepreneurship from cross culture as well as cross country perspective (Wach, 2015). It is basically central to understanding entrepreneurship itself (Gawel, 2013). The push and pull framework (Etemad, 2004) explains the internationalization of SMEs with mediating factor being internal dynamics as IEO. The interaction of the forces can be more effective if a manager has the orientation of entrepreneurship, explaining him/her as the most important in decision making process and also as an intermediating factor at play with dynamic push and pull forces. The study focus on SMEs because, in addition to being sensitive to market changes due to smaller resource capacity, there is need for better understanding of how effectively the organizational capabilities and external factors influence internationalization SMEs to survive in a global market. They also have low tolerance for time-based crisis and low capacity in risk absorption in experimentation in a riskier and highly competitive international market. Another reason for particular attention on SMEs is that unlike larger businesses, SMEs have no any foundation theory to guide them for international growth (Etemad, 2004).

The framework provides for the integration of theories and antecedents from both internal and external source of a firm to explain the internationalization process (Martineau & Pastoriza, 2016) bringing the interaction of the forces between components of push and pull factors, influencing the direction of the firm towards internationalization. The framework will be applied to test internationalization of SMEs in Nigeria considering the lower performance of the sector in the economy and foreign exchange earnings (IMF, 2016; OECD, 2000) and multiple constraints and challenges they face (Abubakar & Yahya, 2013; Okpara, 2009, 2010; World trade report, 2016). Data will be collected to test the interaction of organizational capabilities and environmental factors as push and pull forces in the framework and how they influence the internationalization strategy and capture the internationalization process of SMEs in Nigeria.

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