

State of Internationalization: Issues and challenges for SMEs in Pakistan

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ABSTRACT

The intent is to provide a conceptual framework on internationalization of SMEs, trying to identify those factors, which affect the state of internationalization of SMEs in Pakistan. Family-owned businesses lack in sustaining their share in international markets due to lack of global mindset, utilization of organizational resources, general capabilities, management experience, dynamics of international markets, and regulatory framework while focusing on the internationalization of SMEs particularly from the developing countries like Pakistan. SMEs from Pakistan are working on the traditional patterns and still are unable to capture a significant share in the international markets, rather are losing their share in the international markets. Most of the SMEs in Pakistan are owned and operated by families for decades. With the emergence of financial integration, SMEs are moving across the borders and gaining market share in overseas markets. By selling products in international markets SMEs achieve higher returns and make a significant contribution to the economic growth of Pakistan. This framework suggests the possible factors affecting the performance of family-owned SMEs of Pakistan in international markets. SMEs need to reconsider their strategies, processes, and operations to achieve the required level of market share in international markets.

Keywords: Internationalization, SMEs, Issues and Challenges, Global Mindset, Organizational Resources, Organizational Capabilities, Competitive Advantage, Market Dynamics, Regulatory Framework, and Management Experience.

INTRODUCTION

As internationalization matures, it is becoming a more important and complex process. Yet, it is also becoming a more confused and misunderstood concept (Robson & Turner, 2007). Internationalization has passed the “new flavor of the month” stage. It is firmly embedded in institutional mission statements, policies, and strategies as well as national policy frameworks (Ribau, Moreira, & Raposo, 2018). This signals that internationalization has come of age and is a legitimate area of policy, practice, and research in higher education. However, because of internationalization’s high profile, it is now used to describe anything, and everything remotely linked to the worldwide, intercultural, global, or international scenario. In short, it is a catchall phrase and losing its meaning and direction (Knight, 2015).

In the early 1990s with the emergence of financial integration practitioners and scholars from the domain of entrepreneurship, strategic management and governments considered that the concept of internationalization will boost the growth of SMEs and their share to economic growth (Ramadani, Hisrich, & Gërguri-Rashiti, 2015). The phenomenon of international entrepreneurship has been explained well in the literature by engaging different independent variables, for example, organizational characteristics, environmental factors, and firms’ strategies (Vandekerckhof, Steijvers, & Hendriks, 2015). Most of the studies related to international entrepreneurship have focused on relatively younger high-technology industries located in developed countries or measured the scale of internationalization based on international sales revenue (Cavusgil & Knight, 2015; Martin & Javalgi, 2016). Limited literature has been documented on the family-owned SMEs and internationalization with respect to developing countries because family-owned businesses have significantly different strategies from non-family businesses.

Pakistan being one of the most populous countries of the world constitutes a significant share in the global market, till to date approximately 6.8 million businesses were registered in Pakistan (World Bank, 2018). Approximately 90% of the businesses were registered as SMEs and most are owned and operated by the families over the decades (Adom, 2015). With the emergence of financial integration of foreign businesses entering into international markets, SMEs from Pakistan also started participating in the international markets and capture their respective market share. While, on the other hand existing family-owned businesses operating in international are losing their market share and most of the family-owned SMEs are struggling for the international market exposure (Rahman, Uddin, & Lodorfos, 2017; Kano & Verbeke, 2018). Total exports of Pakistan are 24.7 billion US dollars and SMEs in Pakistan contribute a significant portion in total exports of Pakistan. SMEs contribute about 40% of national GDP and cater to 80% of the non-agriculture labor (SMEDA, 2018). The process of expansion across the borders and need to move beyond the nation’s market is quite inevitable today. The large firms or Multinational Enterprises (MNEs) face fewer hindrances as compared to SMEs (Etemad, 2004). In Pakistan, the SME sector has a lot of potential for growth and development, both in national and international markets due to

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geographical location, skills, and resources (Rabellotti, 2016). Although there are many hurdles for SMEs expansion to international markets but by promoting this sector, it could have a magnificent impact on the economy of Pakistan (Hitt, Li, & Xu, 2016). Not much research has been conducted on the functioning of SMEs and forces affecting the internationalization of SMEs. There is a gap in literature related to this topic (Bose, 2016).

However, very few studies have been conducted on the internationalization of SMEs particularly in the context of Pakistan. According to a current survey, product diversification, innovative capabilities of the entrepreneur, trade opportunities, and availability of market information are the most important factor in terms of internationalization (Zhou & Wu, 2014). On the other hand, trade barriers and hindrances, as well as the unnecessary increase in non-developmental budget, have limited the scope of small businesses in Pakistan from entering international markets (Anwar, Shah, & Khan, 2018).

Previous research in the area of international entrepreneurship has focused on financial outcomes of international entrepreneurship activities such as net income or return on assets, largely based on the degree, speed and scope of a firm's international scales by ignoring non-financial outcomes of a firm's value chain or inputs process, production process, and other organizational factors (Buckley, 2016). Relationships between financial performance and international entrepreneurship activities often are small and not significant (Hilmersson & Johanson, 2016). However, these relationships suffer from accounting issues (e.g. fixed cost allocations, asset amortizations vs. expensing decisions, recognition of sales revenues, profits and income taxation concerns) as well as from time lags between recognition of expenses and sales revenues. Further, financial outcomes of internationalization overlook important strategic benefits resulting from these activities, such as gains in managerial insight, technological learning, networking, and overall improvement of the firm's ability to compete. This study examines the concept of internationalization with focus on non-financial factors with respect to family-owned businesses because family-owned businesses have more focus on strategic performance as compared to financial performance. Prior to this research in the domain of internationalization mainly focused on high-technology industries with samples mostly taken from the US and other developed countries.

This study provides the conceptual understanding of the state of internationalization by its inclusion of four exogenous concepts not yet well-established in entrepreneurial research in family-owned businesses: a global mindset, organizational resources, organizational capabilities, and management experience. Normative theory of dynamic capabilities established that organizational resources and organizational capabilities lead to a competitive advantage, which facilitates internationalization. Moreover, market dynamics and regulatory framework vary across the world, so organizations need to deal with market dynamics and regulatory framework.

This research framework offers the potential to provide strategic and operational recommendations to SMEs and policy guidance to the Pakistani government and organizations owned and operated by families.

Global Mindset and Internationalization

To understand the meaning of the term 'global mindset', it is important to first understand the concept of 'mindset'. The mindset concept originated from the field of Cognitive Psychology and later Organizational Theory, where researchers in these fields study to understand how people and organizations make sense to the world with which they interact (Mendenhall, Osland, Bird, & Oddou, 2017). The global mindset of managers has recently been emphasized as a pre-requisite for early internationalization of firms (Muzychenko & Liesch, 2015). Several empirical studies support this important role of global mindset on international entrepreneurship activities of the firm (Knight & Liesch, 2016). Fuerst and Zettinig (2015) found that new ventures led by managers with global visions can internationalize quickly and successfully. Andresen and Bergdolt, (2017) also reported a positive association between global mindset and international performance of SMEs in their study. Lastly, Felício, Meidutė, and Kyvik, (2016) discovered that rapidly internationalizing firms seem to be more globally oriented than other firms. Global mindset includes pro-activeness that is related to the business activities in terms of awareness and markets' conditions related to an international perspective. Moreover, commitment is related to top-level managers' activities that could positively or negatively affect the entire organization (Chadwick, Super, & Kwon, 2015). Similarly, international vision is related to the entire organization regarding the position in terms of the international marketplace that leads towards internationalization (Thanos, Dimitratos, & Sapouna, 2017).

Organizational Resources and Competitive Advantage

According to Resource-Based View Theory organizations with strategic resources, which include resources that are valuable, rare, difficult to imitate, and non-substitutable have a competitive advantage over other competitors (Ndeisieh, 2018). The strategic resource does not include cash and tangible assets. Strategic resources include organizational processes, resource, capabilities which are rare, so it should be difficult for competitors to acquire. Strategic resources can be trademarks, patents and other resources, which can be hard to imitate and should be non-substitutable. Family-owned businesses in Pakistan are working in a traditional way due to lack of technical and formal education firms are unable to focus on the development of organizational strategic resources, consequently, businesses' failure rate is getting higher (Salanova, Agut, & Peiro, 2005; Kato, Nunes, & Dey, 2016). However, if these factors are operating and generate a positive output that ultimately leads towards the competitive advantage (Anwar, Shah, S, & Khan, 2018).

Organizational Capabilities and Competitive Advantage

Teece, Pisano, and Shuen, (1997) explained the organizational capabilities in Dynamic Capability View Theory as, "the firm's ability to integrate, build, and reconfigure

internal and external competencies to address rapidly changing environments". Similarly, Helfat and Winter, (2011) documented that, "*the capacity of an organization to purposefully create, extend, or modify its resources base*". The underpinning assumption dynamic capabilities framework is that the organizational capabilities should be used to modify short-term competitive position to build a long-term competitive advantage. Organizational capabilities include processes, learning, acquiring new assets and transformation of existing assets, networking and assets orchestration. Moreover, Teece, Peteraf, and Leih, (2016) indicated that organizational capabilities are an important factor in terms of organizational resources and competitive advantage because organizational resources enhance due to organizational capabilities. However, these resources will increase the edge of competitive advantage. As the family-owned SMEs in Pakistan are working on traditional patterns and lack innovation, processes, and are unable to build systemic networking due to lack of technical and professional education (Bose K. T., 2016).

Competitive Advantage and Internationalization

During the 1980s to 1990s, researchers from the domain of strategic management shifted their concentration from industry to firms' related factors and the concept of competitive advantage emerge (Wernerfelt, 1984; Rumelt & Lamb, 1984; Barney, 1986). The term competitive advantage is basically an attribute that allows a company to outperform its competitors. Competitive advantage can be based on three factors are; benefits of products which go to customers, target market customer needs and demands, and competition competitor's, targets and products in a competitive environment (Saeidi, Sofian, Saeidi, & Saeidi, 2015). To gain the competitive advantage organizations needs to align their processes, learning through innovation, acquisition of new assets or transformation of old assets based on strategies (Saebi & Foss, 2015). However, family-owned SMEs in Pakistan lack in innovation in processes or acquisition of new assets and unable to develop systemic networking buyers and suppliers in international markets and as an outcome losing market share and competitive advantage in international markets (Burns, 2016).

Management Experience and Internationalization

Traditionally, internationalization process has been restrained by shortages both in long-term financial resources and in intangible assets, such as managerial skills and attitudes, human capital, innovation and technological capabilities, and knowledge or information about foreign markets and business opportunities (Dominguez & Mayrhofer, 2017). International work experience is a potential asset that increases the source of comparative advantage that automatically leads to internationalization for developing countries (Zheng, Wei, & Yang, 2016). International education is based on some related terms to internationalization, for example, transnational education, borderless education, and cross-border education (Knight, 2015). The role of international education in terms of internationalization is very clear and growing towards the success of any developing countries (Leask, 2015). Participation in conferences/exhibitions facilitates the firms to

achieve the state of internationalization by enhancing the networking based on the participation in international as well as domestic conferences, exhibitions organized by the regulatory authorities and associations. Managers/owners need to participate in exhibitions and conferences to enhance the level of networking to achieve the state of internationalization (Anwar, Shah, S, & Khan, 2018).

Market Dynamics and Internationalization

The increasing level of globalization and international competition among businesses stimulated the need for governance in the international market (Dunning, 1997; Dicken, 1998). Moreover, firms need to consider market dynamics to survive in international markets. Market dynamics and international markets are interdependent and over the period of time interdependence indicates upward trends (Surugiu & Surugiu, 2015). For example, A firm's entry to international markets which could be modest or big as compared to existing markets firms need to imply reconfigurations and need to build interdependence between them. The level of interdependence increases as the firms and markets reach highest levels (Parida & Ortqvist, 2015). SMEs needs to consider market dynamics along with the firm's dynamics to achieve the state of internationalization, with considering the market dynamics firms might not be able to achieve the state of internationalization effectively.

Regulatory Framework and Internationalization

The regulatory framework of overseas markets is an important component and need to be considered by domestic firms while focusing on the state of internationalization. This is another important factor because some international markets are chosen as convenient markets due to locations and regulatory framework in relation to domestic one (Hong, Wang, & Kafourous, 2015). However, there is a difference in the regulatory framework with respect to developing and developed economies and firms need to consider the regulatory framework while going to focus on the state of internationalization. Moreover, the hypothesis related to regulatory pressure assumes that pressure forces the firms towards innovations with a win-win situation and to achieve a sustainable competitive advantage in international markets (Amadeo, 2018).

Despite the growing literature on the intersection between family-owned SMEs and internationalization, this research area is still seeking conclusive knowledge that reconciles the heterogeneous findings obtained (Merino, Monreal-Pérez, & Sánchez-Marín, 2015). Only two recent reviews have been published so far to the best of our knowledge by Kontinen and Ojala (2010) and Pukall and Calabrò (2013), without sound consensus on whether family firms restrain or facilitate the export activity. For example, whereas some studies, for example, Roberts, Zhuge, Monga, Gareau, and Laperle, (2017) found that the small size and flexibility of management teams in family firms allows them to react quickly to new international opportunities.

With the emergence of financial integration and foreign direct investment theory, SMEs start moving to cross the

borders and the concept of resource-based view and dynamic capabilities emphasis on the strategic development which provides the internal strengths to the organization to achieve the competitive advantage which can facilitate the SMEs in international markets (Jones & Wren, 2016). While comparing domestic and international ventures several factors have been observed including; entrepreneurial team knowledge, experience, technical and market knowledge and the potential role of international vision, commitment and pro-activeness towards the internationalization process (Park, 2017). Gaining a competitive advantage is one of the key factors, which provide the foundation to SMEs to operate in the international market. Based on the organizational resources and capabilities SMEs identify and distinct competencies which provide them a competitive edge in international markets (Kim & Hemmert, 2016). In this competitive environment, organizations limit information outflow and use copyrights or patents to deals with a short-term competitive advantage and using organizational resources, capabilities, and management experience firms design their strategies to manage a sustainable competitive advantage in long-term (Martinez-Conesa, Soto-Acosta, & Carayannis, 2017). Insight and experience of top-management, directly and indirectly, play a critical role in the internationalization of firms (Hermano & Martín-Cruz, 2016). Literature documented that SMEs in Pakistan has great potential and opportunities in international markets (Shah, Javed, & Syed, 2013). The major barriers in attaining the status of Internationalization by SMEs include; managerial talents global mindset, and management experience, competitive positioning management of organization resources and capabilities and enough capital (Fayos Gardó, Calderón García, & Mollá Desc, 2015). The government of Pakistan introduced policy and reforms to ensure the supply of financial resource to SMEs on easy terms (Khan, 2011). Focusing on the situation of SMEs in Pakistan, SMEs need to deal with certain discrepancies to achieve the state of internationalization (Bilal, Khan, & Akoorie, 2016).

Theoretical Framework

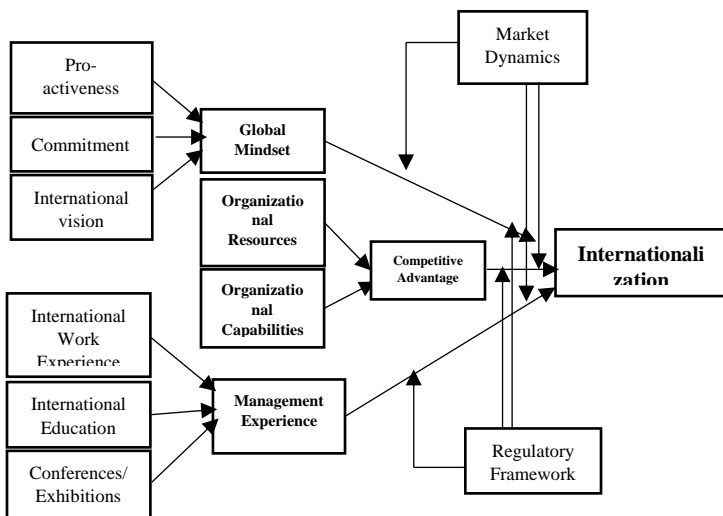


Figure 1: Conceptual framework

CONCLUSION

This study is conducted to contribute to the literature about the state of internationalization of SMEs, particularly in terms of global mindset, organizational resources, organizational capabilities, management experience, market dynamics, and regulatory frameworks need to address to achieve the state of internationalization in Pakistan. SMEs in Pakistan are facing issues and challenges in terms of international activities as compared to South-Asian countries SMEs are successfully achieving their share in international markets. For example, 85% SMEs of Taiwan are exporting their final products and contribute 90% in total exports, while in Pakistan SMEs are unable to capture a significant portion of the international market except for one or two sectors. SMEs of Pakistan lack global markets understanding, dynamic of international markets, access to channels, and knowing which channels are suitable for them. SMEs in Pakistan are working on traditional patterns and SMEs in Pakistan are influenced by families, so families design the business strategies, which is quite difficult to modify quickly based on the business environment. In the current competitive business environment innovation is the key to sustain a competitive advantage in the market, so firms need to have to manage organizational resources and capabilities to compete in the market. Management experience is quite an important factor in the success and survival of SMEs in the international markets because the dynamic and regulatory framework of international markets are different from the locals. So, management experiences guide the SMEs to achieve a competitive advantage or required market share. In Pakistan, most of the businesses registered as SMEs have the potential for growth and development both in national and international markets with respect to different key factors, which this study has explained. SMEs are facing problems like lack of global mindset (unique characteristics), lack of effective management of organizational resources, lack of effective management of organizational capabilities, and lack of management experience in terms of internationalization. Considering these factors and formulating policies and strategies accordingly SMEs could achieve the state of internationalization, which could have an impressive impact on the economy of Pakistan. Future research studies should test the framework empirically in Pakistan or South-Asian region because the basic dynamics of South-Asian countries are the same as well as culture and basic values.

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