Internationalized Small and Medium Enterprises Governance Mechanisms and Capabilities

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Abstract. The study provides a new perspective on internationalized SMEs marketing strategies in the global context. Using a dynamic capability view of the firm, the study develops hierarchical regression models linking global dynamic capabilities and governance structure. A study of 274 internationalized SME Taiwanese firms reveals that two key global dynamic capabilities, namely marketing and design. Our study suggests that internationalized SMEs strategically manage their autonomy and strategic options in choosing the appropriate combinations of different relationship types while they decide to develop global marketing capability, global design capability or both.

Introduction

Inter-firm relationships and governance mechanisms issues are receiving considerable attention in the marketing literature. However, since most of studies emphasize the effect of inter-firm governance mechanisms on resource allocation or firm performance, they are of little help in the study of how governance mechanisms are connected to the development of firms' capabilities [1], especially in international inter-firm relationship. Most of previous related studies are made on the assistance of inter-organizational relationship on organizational capabilities, but limited by resource constraints, internationalized SMEs cannot get access to abundant resources as large firms do to maintain the relationship with foreign firms and capitalize on the relationship. As a result, the relationship-ability-performance inference method is not applicable to SMEs, especially those engaged in internationalization, thus it is necessary to adopt back-stepping method to logically explore how the required capacity can be used to achieving the foreign relationship, which is also the purpose of this study.

Departing from the dynamic capability of firms, our study explores which organizational capabilities have impacts on small and medium size enterprises’ (SMEs) governance choice with their foreign partners [2, 3]. Those firms with higher dynamic capability can reconfigure their processes and structures, and thereby acquire valuable resources while differentiating product mix and marketing activities from competitors [3, 4, 5, 6, 7]. Particularly, the emergence of the knowledge economy, intense global competition and considerable technological advance make dynamic capability become increasingly important to international competitiveness. This suggests that better understanding on origins of capability becomes evident under a dynamic international context. To integrate the literature on dynamic capabilities with the international marketing literature, we define global dynamic capabilities (GDCs) as responsiveness and efficiency of internationalized firms processes for maintaining existed customers value and creating value-adding products and market niches in response to foreign market changes.

Literatures Review

Global Dynamic Capabilities

Eisenhardt and Martin [5] define dynamic capabilities as “firm’s processes that use
resources—specifically, processes to integrate, reconfigure, gain and release resources—to match and even create market change” and “organizational and strategic routines by which firms achieve new resources and configurations as markets emerge, collide, split, evolve, and die” (p. 1107). Through these processes, firms constantly integrate, reconfigure, renew, and recreate resources and capabilities [8, 9] and, most importantly, upgrade and reconstruct their core capabilities in response to the changing environment to attain and sustain competitive advantage [10].

Some scholars believed that local and global difference will make a big difference in firm performance. In this vein, few studies have advanced the notion that firms compete with one another based on their dynamic capabilities in foreign markets, especially for internationalized enterprises which typically face fast-moving environments with fierce global competition [11]. Therefore, reviewing the structure and operation of dynamic capability from global perspective will facilitate the DC theory building and to develop more managerially relevant insights.

In the internationalization context, scholars defined dynamic capability as a firm’s learning, improving, changing knowledge and routines to develop capabilities in order to influence internationalization success. Focusing on creation, implementation, delivering of foreign customers, and market value helps us to distinguish GDCs from dynamic capabilities in general [12]. Such abilities show primary traits: (1) developing a systemic global coherence while recognizing unique features of each country’s environment to facilitate customization of an individual country’s strategies; and (2) adapting, integrating, and reconfiguring both internal and external assets to match opportunities in global marketplaces [4, 5]. In sum, all of these efforts and capabilities are vital to SMEs’ survival and growth in foreign markets [13].

GDC is also a high-order construct which includes various core capabilities [2, 3, 8], as Chiavesio et al. argue that globalization and the widespread diffusion of ICTs, lead traditional SMEs to develop design and marketing capabilities that they were not used to foster. Therefore, we focus on capabilities of marketing [14,15] and design [2, 13,16]. In order to achieve both goals, this study refers to Teece’s (2007) suggestions by dividing GDCs into GMCs and GPDCs since better both capabilities can help firms to handle increasingly sophisticated demands of globalized customers or predict fast changing technological development [4, 9].

**Relationship between Global Dynamic Capabilities and Governance Mechanisms**

Global marketing capability is usually seen as a capacity to coordinate and integrate internal resources and skills to address rapidly changing foreign markets or customer needs [14]. Morgan, Vorhies, and Mason [17] find value-creation mechanisms of marketing capability especially immobile, difficult to replicate, and largely non-substitutable, which was empirically verified [18]. Synthesizing insights in literatures, Vorhies and Morgan [18] distinguish the contribution of marketing capabilities to business performance which including product management, pricing, channel management, marketing communication, selling, market information management, marketing planning, and marketing implementation [17]. Since implementing lower-level capabilities is a necessary condition for developing higher-level capabilities, we focus on four marketing mix capabilities based on marketing’s 4Ps: pricing capability, product management capability, place (distribution) capability, and promotion (marketing communication) capability. We choose these capabilities because they are thoroughly addressed in extant literatures [18] and because 4Ps are a prominent concept across countries at variant stages of development or manifesting cultural properties.

The development of marketing capabilities enhances the SME’s ability to search and select customers who are suitable to cooperate with. These capabilities broaden their market spectrum beyond the local environment. Marketing-based SMEs are more inclined to focus on exploitation of old certainties [19] on a broader market than explore possibilities in terms of new products and new ways of interaction with customers (Furlan et al., 2007). When the SME exhibits a higher level of marketing capability, it is likely to opt for contractual governance because of its unfamiliarity with international transactions in general, and local market conditions, in particular. Because the SME is lack of confident about operating in foreign markets and with foreign firms, it is well positioned to
anticipate circumstances and select contractual governance mechanism that addresses such scenarios. Therefore, an internationalized SME is likely to prefer a legal governance structure against uncertainty. Additionally, the SME can turn to its ability and experience to work with foreign firms to enforce the contractual provisions.

Product development and design are vital functions in development and utilization of firm knowledge, particularly in global competition [20]. Accordingly, robust design capabilities offer greater potential to develop acceptable products to broader targeted segments, events, and/or conditions with costs offset by anticipated organizational benefits. Implementation of robust design is expected to reduce the number of new components, parts, materials, and technologies across a product family over time. Such implementation means increasing product line variety, lowering manufacturing costs, speeding technological improvement of products, expediting marketing of new products, and thereby subsequently increasing the number and size of target segments.

Moreover, design capabilities improve the SME's absorptive capacity facilitating learning from customers and creation of relational rents deriving from reciprocal commitment [21, 22]. Investing in design capabilities leads SMEs to develop thicker, hand-in-glove relationships with other firms not necessarily located in the originating local cluster. Design-based SMEs leverage on design capabilities to open up their governance mechanism of inter-firm relationship and engage in more complex and remunerative ones (i.e. relational governance). After exploring new knowledge avenues by investing in design capabilities, they exploit such knowledge modifying their governance mechanism towards more autonomous configurations [23]. This problem has been discussed by Martin and Salomon [24] who note that too much tacitness can become a burden to an internationalizing SEM. The success of design capability depends on their relational governance, which allows them to translate their technological knowledge into commercially successful innovations. A design-based SME may be interested in co-operating with a large international firm with effective distribution channels in order to reach foreign markets.

Method

Sampling
The survey targeted SMEs, defined as enterprises with the number less than 500 employees, and was conducted by computer-assisted telephone interviews. This study surveyed informants’ (CEOs, vice presidents, senior managers) knowledge about and shouldering responsibilities related to their companies. As these top managers can well master most company’s businesses and familiarize with actual situations of internationalization, capability development and operation of the company, this study selected such persons as the main information providers. We sent 1,000 questionnaires and received 224 completed answer, making 22.4% of response rate. After eliminating 18 invalid questionnaires, there were 206 valid ones left with a 20.6% of effective response rate.

Measures

Global marketing capability. GMCs was measured via a seven-point scale developed by Weerawardena and O'Cass [7] to capture capacity of firms to use marketing tools and reach target global markets effectively, by focusing on firms’ capability to undertake key marketing functions in the global context. Global product-design capability. We adopted a conceptual framework developed by Swan et al. [16] and identified four dimensions for measuring GPDCs, which included three items for functional capability, three items for esthetic capability, three items for technological capability, four items for Quality-based capability. Relational governance Following the research of Claro, Hagelaar, and Omta [25], two dimensions construct relational governance: joint planning (four items) and joint problem solving (four items). Contractual governance We measure contractual governance with formative scale taken from Ferguson, Paulin, and Bergeron [26], the extent to which legal ties were implemented in the exchange, using 4 items that we adapted to the global context.
Results

To investigate the relationship between internationalized SMEs' global dynamic capabilities (GMCs and GPDCs) and governance structure (relational governance and contractual governance), this study divided our sample into four subsamples. Following K-means algorithm, groups were constructed, based on GMCs and GPDCs as low GPDCs/GMCs (lack of orientation), low GPDCs/high GMCs (GMCs oriented SMEs), high GPDCs/low GMCs (GPDCs oriented SMEs) and high GPDCs/GMCs (ambidextrous SMEs). A paired sample t-test was conducted on the summed mean for the relational and contractual governance, the results of which are shown in Table 4. Some significant differences were found between the relational and contractual governance in group 2, group 3, and group 4.

In addition, if GPDCs oriented SMEs cooperate with foreign partners by contract as they develop foreign market, face to the product demand of various customers and devote themselves to GPDCs, they will not able to acquire effective information about the products in the market. In the relational governance, joint planning and joint problem-solving will be conducive to promoting the interaction between manufacturers and their foreign partners for they are willing to provide complete and accurate information and exchange with each other, so that the manufacturers can combine this information with the internal existing products efficiently and advance their GPDCs. Thus H2 received support. Finally, in order to test the ambidextrous effect of developing GMCs and GPDCs together, it found a significant difference in group that ambidextrous SMEs preferred relational governance more than contractual governance.

Table 1. Paired sample t-test of relational and contractual governance.

<table>
<thead>
<tr>
<th>Category</th>
<th>N</th>
<th>Governance structure</th>
<th>Mean</th>
<th>SD</th>
<th>t</th>
<th>p-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Group 1</td>
<td>12</td>
<td>relational governance</td>
<td>3.82</td>
<td>1.53</td>
<td>.498</td>
<td>.628</td>
</tr>
<tr>
<td></td>
<td></td>
<td>contractual governance</td>
<td>3.71</td>
<td>1.26</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Group 2</td>
<td>55</td>
<td>relational governance</td>
<td>5.18</td>
<td>0.49</td>
<td>2.667**</td>
<td>.010</td>
</tr>
<tr>
<td></td>
<td></td>
<td>contractual governance</td>
<td>4.77</td>
<td>0.90</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Group 3</td>
<td>36</td>
<td>relational governance</td>
<td>4.61</td>
<td>0.55</td>
<td>3.682***</td>
<td>.001</td>
</tr>
<tr>
<td></td>
<td></td>
<td>contractual governance</td>
<td>4.13</td>
<td>0.78</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Group 4</td>
<td>103</td>
<td>relational governance</td>
<td>5.90</td>
<td>0.57</td>
<td>7.863***</td>
<td>.000</td>
</tr>
</tbody>
</table>

Discussions

Our approach overcomes the typical drawbacks of analysis based on vertical dyadic relationships. We show that SMEs strategically and deliberately manage a portfolio of different relationships, not single ones. We emphasize that GPDCs and GMCs shape SMEs' autonomy and strategic options in choosing the right balance between different relationships. Contractual governance, though important, are not the exclusive type of governance structure that SMSs engage in. Neglecting other types of governance structure (i.e. relational governance) may be misleading in understanding SMEs' evolution and assessing their competitiveness.

Another original contribution of this study is related to the international marketing management literature. As argued by Mota and de Castro [1], the majority of the studies dealing with relationships portfolios can hardly be used to interpret the coevolution among capabilities and relationships over time. Our research points out that manufacturers will tend to choose different governance structures to strengthen their competitiveness in the different development phases of global dynamic capabilities. For the internationalized SMEs, although choosing to use contractual governance can be conducive to lowering uncertainty and speculation, the single development and common development of GPDCs and GMCs still stress on strengthening the interaction with management partners and relational governance as the main direction.
References


