

Internationalization and Performance: Small and Medium Enterprises (SMEs) in Malaysia

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Abstract

Despite the importance of Small and Medium Enterprises (SMEs) and its role as a key participant in international business, empirical research on Malaysian SMEs in the area of internationalization has been limited. In an attempt to investigate the relationship of internationalization and performance of SMEs, this study focuses on SMEs in the Malaysian manufacturing sector. The conceptual framework is developed based on previous literature gaps on SME internationalization and firm performance. A sample of 77 SMEs in the manufacturing sector has participated in this research. Using a structured questionnaire, the data was collected through the post from SMEs located in the northern region of Peninsular Malaysia. The study showed a significant relationship between internationalization and performance. This result poses some implications to managers and policy makers.

Keywords: Internationalization, Index of internationalization, Index of performance, Small and medium enterprises

1. Introduction

Internationalization is a major dimension of the growth of a firm (Peng & Delios, 2006). Market liberalization and digitization are encouraging large corporations and the SMEs to operate beyond their national borders and compete with each other in foreign countries and new regions (Barkema, Baum & Mannix, 2002). During the past decade, popular terms used in the economic circles have been “globalization”, “internationalization” and “liberalization”. Issues related to globalization, internationalization and liberalization have received a great deal of attention in recent research. A study commissioned by the Organization for Economic Cooperation and Development (OECD) (1997) on the globalization of SMEs, provides evidence from 18 member countries that suggests Small and Medium Enterprises (SMEs) are internationalizing more rapidly than in the past and provides evidence of small firms that became involved in international business activities almost from inception.

Generally, most of these SMEs are generating earnings in the global markets more than in the home countries. These firms, can be described as “born global” or “instant internationals” (traditional SMEs which enter international field almost from inception), “backsources” (SMEs who re-concentrate their international activities back to the home base) and “born regional’s” (SMEs that gain their force out of a local embeddedness and never shift capacity beyond export activities) (Schulz, Borghoff, Kraus, 2009). Only in last decade, there have been growing interest among the academics and business practitioners in the international business on the

internationalization of SMEs in emerging economies, such as China (Ahlstrom, Bruton, & Yeh, 2008), India (Saini & Budhwar, 2008), Taiwan and Singapore (Sim & Pandian, 2003) and Vietnam (Thai and Chong, 2008).

In most recent studies in China and Japan by Yang, Jiang, Kang and Ke (2009), internationalization has brought success to Haier and Matsushita. They have suggested that firm internationalize, in addition to being influenced broadly by industry- and resource-based considerations, is inherently shaped by the domestic and international institutional frameworks governing these endeavors. In Malaysia, the role of government of Malaysia and the SME business strategy (Hashim & Hassan, 2008) further encourage the development of the SME sector. It is stipulated very clearly in the National Economic Policy and the Malaysian Development Plans (the five-year plans). Two main policy guidelines established are: (a) the SMEs should produce quality and high value-added products and services for both domestic and export markets, and (b) the SMEs should increase productivity through the use of modern technology and management which will help to increase the competitiveness of the SMEs in the export market (Hashim, 2000a). Therefore, globalization pressure suggests that there is a need to study empirically why SMEs internationalize and how it affects their performance in the Malaysian environment.

2. Review of literature and hypothesis development

The view that internationalizing firms report superior performance is a widely received wisdom and it is acknowledged that this view is widely assumed although not directly stated by many academics and practitioners (Wright, Westhead, & Ucbasaran, 2007). The following section on the review of literature about the SMEs in Malaysia shows there is a need to explore the relationship of internationalization and performance. This will help in a manifestation of the holistic approach of the government efforts to internationalize as many SMEs as possible.

2.1 SMEs

2.1.1 Definition of SMEs in Malaysia

In broader perspective, Arbaugh, Camp, and Cox (2008) defines enterprising firms as one which is designed to create wealth through new economic activity by bringing together unique packages of resources to exploit marketplace opportunities. In international business, researchers and practitioners define SMEs based on the socioeconomic development of each country. In the United States, an SME is a company with 500 or fewer employees (Cavusgil, Knight & Riesenberger, 2008). In Taiwan, Lin & Chaney (2007) has defined SMEs in their studies as an establishment with 650 employees or less. In Malaysia, the criteria used to define SME contributed by government agencies and prominent researchers in the areas of SMEs in Malaysia. According to the definition, a small-scale firm is a company with less than 50 full-time employees and with an annual turnover of not more than RM10 million, whereas, a medium-scale enterprise is a company with 51 to 150 employees and with an annual turnover of between RM10 million and RM25 million. Hashim and Abdullah (2000) has introduced the quantitative criteria to further refine SMEs in Malaysia by including the following; (a) it is actively managed by its owners, or in another words, "owner-managed and family business", (b) it is highly personalized (i.e. with an owner's preferred management style), (c) it is largely local in its area of operation, and (d) it is largely dependent on internal sources of capital to finance its growth. The rationale behind the inclusion of these four qualitative characteristics is to establish the entrepreneurial orientation that will reflect the general ownership profile of SMEs in Malaysia. Therefore, the SMEs in this study are observing the above criteria during the sample selection activity.

2.1.2 SMEs potential and growth

Success in domestic opportunities may limit the SMEs' ability to conceive and pursue internationalization. As firms find domestic success, they tend to focus on cultivating domestic networks as opposed to investigating potential international markets (Arbaugh et al., 2008). In another note, success in domestic market can be a greater push factor for firm internationalization (Cavusgil et al., 2008). For example, SMEs in Europe has shown interest in market seeking in global market after establishing in domestic market (Svetlicic, Jaklic, & Burger, 2007). In recent statistics, SMEs represent 99.2 percent of total business establishments in Malaysia, contributing to 32 percent of GDP, 19 percent of exports, and 56 percent of employment in Malaysia. MITI expects the SMEs sector to contribute more between the period of 2000 and 2020. The SMEs are expected to contribute 50 percent of the gross domestic product (GDP) in 2020 (Hashim, 2000b). The exporters in SMEs are mainly located in the manufacturing sector (57.6%), services (40.6%) and agriculture (1.8%). Based on the statements made by various organizations and ministries over the past decades, the total SMEs could be in the range of 10,000 to 30,000. Recognizing the SMEs potential and future growth to the economy of the country, the government of Malaysia has initiated greater efforts in encouraging SMEs involve in international business. For instance, in 2008, it has allocated RM3.2 billion for 198 SME development programs across all economic sectors. The main

aims are to: enhance supporting infrastructure for SMEs, increase capacity building to strengthen SMEs, and improve access to financing. In line with strategies formulated in the Ninth Malaysian Plan and the Third Industrial Master Plan (IMP3), the main focus for 2008 was to promote SMEs in the services, primary agriculture and agro-based sectors (Ninth Malaysia Plan, 2006). These statistics indicates that the SMEs contribute significantly to the Malaysian economy as well as increasing roles in international trade.

2.2 SMEs internationalization

Internationalization is the extent to which a firm is involved in international business. It includes exporting, the presence of foreign subsidiaries, shares ownership by foreigners and the appointment of foreigners in the organizational structure. Bartlett and Ghoshal (2000) have identified two main motivations for firms' internationalization: traditional motivations and emerging motivations. Among the earliest motivations that drove companies to invest abroad was the need to secure key supplies, especially minerals, energy, and scarce raw material resources. Another strong trigger of internationalization could be described as the market seeking behavior. This motivation was particularly strong in companies that had some intrinsic advantage, typically related to their technology or their brand recognition that gave them some competitive advantage in offshore markets. Another traditional and important trigger of internationalization was the desire to access low-cost factors of production. For example, the availability of lower-cost capital also became a strong force for internationalization.

Bartlett and Ghoshal (2000) further outlined the emerging motivations for firm internationalization. In many cases, the new motivations were driven by a set of economic, technological, and social developments that made internationalization essential for a company to survive in particular businesses. For example, successive rounds of technological change brought about by the adoption of integrated circuits, auto-insertion machines, printed circuit boards, and computerized assembly and testing raised the efficient scale for production of color television sets from about half a million sets a year to over three million sets. As a result, companies that had historically focused only on their domestic markets had to either become international or go out of business since few countries were large enough to support production at such scale by individual companies.

Baird, Lyles and Orris (1994) examined the strategic and organizational responses of small firms to global competition. One of the key objectives of the study was to assess the relationship between international strategy and firm performance. The independent variables used were the nature of the firm and industry that determined small business international strategy and performance. The results showed that international strategy is positively related to return on sales but negatively related to growth. The study suggested that the effects of the stages of the industry life cycle on sales growth should be separated. Furthermore, it indicated that firms that internationalize are relatively larger and tend to be from the manufacturing background. It also supported earlier studies that showed international small businesses tended to build their competitive advantage on a patent or manufacturing capability and process changes.

Jones (1999) studied 196 small high-technology firms to explore their patterns of international development through their establishment of cross-border activity in key value chains and associated service activities. The findings showed that most small high- technology firms realize that international business activity is crucial for their survival. The results also suggested that expansion through the conventional, incremental export development route should not be the only mode of internationalization. The scope for international development is tremendous and encompasses wide areas of international management. Expanding into international markets is often used by firms that seek rapid growth. As a prerequisite, Bradley and O'Reagain (2001) asserted that SMEs should exploit the domestic market opportunities to build up company resources, focusing particularly on developing a high capability, broadly-based management team and an efficient integration of the business system. SMEs should accordingly concentrate on the product-market segment, either local or abroad, where the core competencies of the firm provide a competitive advantage.

The manufacturing sector in this study refers to the economic sector that is involved in activities such as processing, assembling and producing final products for both local and export market. Abdul Talib and Md. Salleh (1997) have pointed out some critical evaluation concerning the relationship between firm size and attitudes toward exporting. The results demonstrated that SMEs have stronger tendency towards exporting activities than large sized firms. SMEs are also found to be actively exploring market potential in the international arena. In other words, these firms are looking for broader market for their products. Obviously, all firms in the study believe that exporting is a desirable activity and can contribute significantly to the firm's growth and profit.

2.2.1 Components of SMEs internationalization

Sullivan (1994) has contributed to the firm internationalization through a study which is representative, diverse and helpful for the development of meaningful measures of internationalization. His study shows that foreign sales as a percentage of total sales (FSTS) have been primarily used to measure internationalization. Contractor, Kundu and, Chin (2003) measured internationalization through the eigenvector-weighted sum of FSTS (foreign sales/total sales), FETE (number of foreign employees/number of total employees) and FOTO (number of foreign offices/number of total offices). Manolova, Brush, Edelman, and Greene (2002) measured internationalization based on firm activities such as import, direct export, export through an intermediary, solo venture direct investment, joint venture direct investment, licensing of a product or service, contracting and, franchise.

In a separate study, Reuber and Fischer (1997) included three components to measure the internationalization of SMEs. The first component is FSTS which is a standard single-item measure of the degree of internationalization. The second component is the percentage of the firm's employees that spend over 50 percent of their time on international activities, to capture the structural aspects of an SME's degree of internationalization. The third component measures the geographic scope of sales by understanding the amount of sales from the different regions and countries. The three items were converted into a ratio measure and summed to create a single score.

Ogbuehi and Longfellow (1994) operationalized the internationalization of American manufacturing SMEs as the length of time the firms have been involved in exporting. Specifically, internationalization was measured by asking respondents the following single question, "How long has your company been actively involved in exporting?" The response categories ranged from 1=not involved to 5=over 20 years. Ogbuehi and Longfellow (1994) suggested the use of other measures in future research such as export sales as a percent of total sales, growth in export sales and the number of export destination countries. Sullivan (1994) argued that, based on the precepts of the measurement theory, multiple item measures should be used in measuring internationalization instead of single units. Sullivan (1994) constructed a five-item measure that reflects performance aspects of internationalization (foreign sales as a percentage of total sales (FSTS), structural aspects of internationalization (foreign assets as a percentage of total assets and overseas subsidiaries as a percentage of total subsidiaries) and attitudinal aspects of internationalization (top managers' international experience and the psychic dispersion of international operations).

2.3 Firm performance

Firm performance refers to the level of success of the firm. Jones's (1999) study on the process of internationalization showed the value of cross-border activity in relation to small firm growth. He stressed that small high-technology firms in his sample that are extensively externally networked are among the most successful in the domestic market. SMEs that have internationalized are able to create knowledge, technology skills, and diversified resources and stimulate development, growth and success. Besides that, Bradley and O'Reagain (2001) commented that SMEs could internationalize to seek rapid growth. Growth can be measured in firm performance through export sales. The study suggested that internationalization have a positive relationship with firm performance.

Burpitt and Rondinelli's (2000) study showed that financial success in initial exporting activities motivates small firms to internationalize in subsequent periods. Firms agreed that sales, profit and growth would be important factors to their internationalization. This shows that internationalization will help firms to achieve financial success. Partial correlation analyses have showed that both financial success and learning oriented variables are related to a likelihood of continued exporting by small firms. A study by Yip, Biscarri and Monti (1999) on 68 mid-sized United States based companies showed that firms that follow a systematic internationalization approach can achieve significant performance. The six systematic internationalization approaches are motivation and strategic planning, market research, market selection, selection of the entry mode, planning for post entry problems and commitment of resources.

Chatterjee and Lim (2000) studied the relationship between the external factors and internal factors of SMEs in Singapore with the degree of internationalization and performance. The results show that a positive relationship exists between internationalization and performance. Regionalization and internationalization have proved to be a successful combined pathway to the success of SMEs in Singapore. Moreover, they tend to regionalize because markets like Malaysia and Indonesia are almost similar to them in cultural aspects and this enables easy market penetration.

Moini (1995) addressed export profitability as this had not been included in his study of the internationalization of small firms. He further justified that the level of profit would be a strong factor in management willingness to

enter export activity. Besides that, Parnell (2002) had reviewed the current challenges and new directions in competitive research. He has outlined the major conceptual and empirical challenges facing competitive strategy researchers and outlined recommendations for future research. Organizational performance was traditionally measured using accounting data such as returns on investment, revenue growth and market share. He has suggested the inclusion of qualitative measures to provide insight into organizational processes and outcomes.

2.3.1 Components of firm performance

The approach to measure financial performance was adopted from Beal (2000) with a little amendment that includes people turnover. All the answers are in percentage. Therefore, performance is measured through the growth of sales and the growth of profit for the previous five years and the people turnover rate. Hashim (2000c) adopted the business performance composite index (BPCI) as the mean value of the return on investments (ROI), the return on sales (ROS) and the return on assets (ROA). The BPCI is operationalized as: $BPCI = (ROI + ROS + ROA)/3$.

This study used the following quantitative components of financial performance suggested by many researchers: (a) the annual average sales growth rate, (b) the rate of profit (net profit/sales \times percentage), and (c) the staff turnover rate (people leaving the organization). The questionnaire requested the respondents to make calculations based on five years average to smooth the impact of fluctuations to the companies. After a thorough review of internationalization and firm performance, we are ready to hypothesize the relationship between the former and later as the following:

There is a positive relationship between internationalization and the firm performance in SMEs

3. Research model

Based on the above discussion, the research model for this paper was extracted from a wider research framework as depicted in Figure 1.0.

4. Methodology

4.1 Research design and sampling

Firms to be contacted were identified from the registered list of companies in the Federation of Manufacturing Companies (FMM) directory, which is the most comprehensive list of SMEs database. This study used SMEs in Perak, Pulau Pinang, Kedah and Perlis as a sampling population. Probability sampling is used as the sampling design. In the probability sampling design, stratified random sampling process was applied to choose the sample. The sample was from manufacturing companies. Manufacturing companies are considered appropriate for this study for two reasons. First, the manufacturing industry is one of the major contributors to the economy. Secondly, the manufacturing industry is the most vulnerable to globalization. The selection of the sample was based on the manufacturing SMEs with the number of employees not more than 150, operating for a minimum of three years, established as of Malaysian origin and have been involved in exporting activities.

Stratified random sampling, as its name implies, involves a process of stratification or segregation, followed by random selection of subjects from each stratum. In this study, the population of 1,363 SMEs was segregated based on the combination of criteria explained above. Based on these criteria, total of 300 SMEs were selected from the total of 1,363 SMEs. Since only 300 SMEs qualify with the criteria, no random selection was used instead. All the selected 300 SMEs were used as sample in this study.

The unit of analysis in this study is the individual SME. The respondents (i.e., executives, CEOs and upper-level managers with a strategic responsibility for their firms) were identified on the basis of their job title and position within the company (Vida, Reardon & Fairhurst, 2000). They will be assumed to be knowledgeable and familiar with the operations related to the issues under investigation. The questionnaires were sent through post (60%) and e-mail (40%). Questionnaires that sent through post were attached with stamped envelope to encourage reply from the respondents. Follow-up e-mails were sent as a reminder to the respondents. The study was conducted between 30 March and 2 September 2003. Questions were pre-tested with a sample of 10 SMEs in order to ensure that they were clear and captured the desired information. The questionnaire is divided into several sections which include information about the background of the company, internationalization and performance. Regression analysis was used to test the hypothesis.

4.2 Measurements

4.2.1 Development of the Index of Internationalization

Measuring internationalization through indices will be explored in this study as a contribution to the knowledge of internationalization. Using indices for measurements is widely accepted in literature. For example, Beal (2000)

used indices to measure environmental scanning. Beal (2000) also used the frequency of scanning and scope of scanning in constructing scanning indices. In addition, six scanning indices based on CEO's scope of scanning and six indices based on the frequency of CEO's scanning were developed. As mentioned earlier, the components of internationalization used in this study are the following; the percentage of sales from international sources, the percentage of profit from international sources, the composition of Board of Directors' members who are foreigners, the composition of managers and heads of department who are foreigners, the number of nationalities working in the firm, the number of countries the firm operates in and the percentage of shares in the firm owned by foreigners.

Internationalization is measured using both ordinal and scale measures. The percentage of sales from international sources and the percentage of profit from international sources are measured using ordinal measures. Other constructs, such as the number of foreigners on the Board of Directors, the number of expatriates who are managers, the number of countries exporting, the percentage of shares owned by foreigners and the number of overseas subsidiaries or joint ventures, are measured using scale measures.

The present study is using an index to measure internationalization. There is no study has attempted to use an index to measure internationalization. The weightage developed for the index is an arbitrary number since there is no baseline reference could be made from the past studies. This attempt is similar to Sullivan (1994) who has developed for the first time the accumulation of ratios to measure DOI which consists of more than one item measurements. Selected internationalization variables were put into this index following a factor analysis which showed that these variables fall into one factor. The excluded variables are the number of foreigners on the Board of Directors, the expatriates who act as managers or heads of departments and the percentage of shares owned by foreigners. In this study, the majority of the respondents' firms do not have foreigners on the Board of Directors or in top management; likewise, no shares are owned by foreigners. Even though these variables may well explain the presence of internationalization of any type of firm, SMEs in this sample does not include foreign ownership and solely representative of Malaysian ownership. Therefore, these variables were excluded from the index.

Many studies have used the percentage of sales and profits from international sources as a better way to measure internationalization. Almost all the literature uses these variables to measure internationalization because it reflects instantaneously the amount of export sales and profit from export businesses. Table 1.0 show that approximately 40 percent of the SMEs in this study achieve 11-20 percent of their sales and profit from international sources. Therefore, the relatively higher weightage of 30 each was given for both constructs. Next, the number of countries a firm exports to and total overseas subsidiaries and joint ventures are given relatively a smaller weightage of 15 each. Approximately 75 percent of the SMEs in this study export to less than 10 countries while 60 percent of SMEs have less than three subsidiaries or joint ventures. Therefore, it is appropriate to give a smaller weightage for both variables. The lowest weightage of 10 is given to the duration a firm spends in international businesses. The literature review suggests that there are some SMEs who have been involved in internationalization since inception. Nevertheless, it is included in the index since Table 1.0 shows that 78 percent of the SMEs in this study have been involved in international business less than 15 years. The selected variables and its weightages are shown in Table 2.0. Acknowledge that these numbers are arbitrary since there is no past research using index to measure internationalization. The weightage development of 30, 15 and 10 as used in this study are still at the early stage of exploration for a scientific study. The index was named the index of internationalization (IOI) as shown in Table 3.0 as a percentage of respondents in the respective index. Table 3.0 shows that 33.8 percent of respondents have obtained an index 51 and above, demonstrating a significant involvement in international businesses. It shows that Malaysian SMEs have internationalized significantly.

4.2.2 Development of the Index of Performance

For this study, performance is measured in terms of the average sales growth, the average rate of profit or return on sales (ROS) and low people turnover. These performance measurements are formulated into an index of performance. Performance variables are also put into an index following factor analysis which shows that they are highly correlated. The literature review shows that the index is a better way to measure performance as explained in the previous chapter. Firm performance is measured using ordinal scales for constructs such as the average sales growth, the average rate of profit and staff turnover.

Sales growth and profitability are the most recognized performance indicators because they directly measure what are most desired by shareholders and investors in the firm. The literature review also shows that the majorities of studies have used sales growth and return on sales (ROS) to measure performance. Furthermore,

the higher the export sale, the higher will be the sales growth and ROS of a firm. Therefore, relatively a higher weightage of 40 percent has been attributed to each of the two constructs. The employee turnover reflects employee morale and motivation which is an indication of how well the firm is able to fulfill their basic needs and work life effectiveness. The literature review shows that internationalization requires a high level of resource commitment. SMEs may face challenges during resource relocation to overseas or demands a high level of expectation from employees. This will create unnecessary people issues if not managed effectively. Therefore, employee turnover can be a good indicator for firm performance. It is given a weightage of 20. The index of performance is shown in Table 4.0.

Similar to index of internationalization, these weightages are arbitrary since there is no past research using this type of index to measure performance. The weightage development of 40 and 20 as used in this study are still at the early stage of exploration for a scientific study. Table 4.0 shows that 89.6 percent of the SMEs obtained scores of more than 51 which significantly show that SMEs achieve high performance with internationalization. The following section explains the correlation among the dependent and independent variables, using the Pearson correlation.

5. Findings

5.1 Description statistics

Table 1.0 shows the percentage of sales from international sources. It shows that 44.2 percent of SMEs enjoy 11 percent - 20 percent sales from such sources, whereas 26.0 percent of them receive more than 70 percent of sales. A total of 42.9 percent of SMEs receive 11 percent to 20 percent of profits from international sources. More than 70 percent of profits are enjoyed by 19.5 percent of the SMEs, whereas 13.0 percent have acquired 6 percent to 10 percent of the profits from international sources. It also shows that the majority of the respondents' firms do not have foreigners on it. It also shows majority of the foreigners not holding any positions in the management team. The majority of the respondents' companies (41.6 percent) export to 1 to 5 countries. In addition, 33.8 percent of the SMEs export to 6 to 10 countries. It is also clear that the majority of the respondents do not have shares owned by foreigners. Result shows that 54 percent of the SMEs have at a minimum three overseas subsidiaries or joint ventures. A total of 36.4 percent of respondents have been involved between 6 to 10 years in international businesses.

Table 1.0 shows the annual average sales growth in the SMEs. The majority (58.4 percent) register annual average sales growth of 6 percent to 10 percent. Besides that, 19.5 percent of the SMEs have sustained 11 percent to 15 percent average sales growth for the past five years. The highest average profit percentage of 40.3 percent of SMEs falls into the range of 6 percent -10 percent profits. The average rate of profits of 1 percent - 5 percent is enjoyed by 22.1 percent of the SMEs. More than 35 percent receive an average rate of profits higher than 11 percent. It is significantly shown that 55.8 percent of the SMEs score a turnover rate of 1 percent to 5 percent.

5.2 Direct relationship between SME internationalization and firm performance

A total of 300 companies were selected based on the criteria of being a manufacturing SME. Eighty one questionnaires were returned, yielding a response rate of 27.0 percent, but only 77 responses are complete and used in the statistical analysis. There are seven categories to explain the background of the 77 companies that is used in the analysis, mainly on the type of industry, position of respondents, SME ownership, total employees, number of years of establishment, location of the companies and total assets. The factors are recorded as new variables and treated to Pearson Correlation analysis to see the bivariate relationship of the variables. The result shows that internationalization is significantly correlated with performance ($r=0.39$, $p<0.01$).

Table 5.0 shows the result of the regression analysis for testing the hypothesis. The regression analysis shows that 16 percent (R^2) of the variance in performance has been significantly explained by internationalization. The F statistic is 13.82 which is significant at $p<0.01$. The beta value is 0.39 which shows that a positive relationship between internationalization and performance exists. Therefore, hypothesis is substantiated.

6. Discussion and conclusions

6.1 SME internationalization and firm performance

This study convincingly demonstrates that internationalization and performance have a positive relationship. The findings are consistent with both internationalization process theory and emerging motivations of internationalization. The findings indicate that internationalization can improve performance and motivate firms to continuously capture foreign markets.

This result is congruent with the study of Baird et al. (1994) which showed that internationalization has a positive relationship with the performance of small businesses. It shows that SMEs can increase their return on sales (ROS) by taking their current products into foreign markets either on their own or through foreign alliances. This study also supports the findings of Burpitt and Rondinelli (2000) which showed that financial success allows aggressive strategies of internationalization. The present study further supports the findings by Contractor, Kundu and Chin (2003) which indicated that internationalization and performance have a positive relationship. The study results of Chatterjee and Lim (2000) in Singapore on the relationship between internationalization and performance attest to the positive link. Therefore, there is conclusive evidence that internationalization and performance are positively related.

The present study supports the findings of Vida et al. (2000) that conclude internationalization can be considered as a growth strategy which can be related to firm performance. Jones (1999) found that most small high technology firms realize that international business activity is crucial for their survival and sustain growth level at a satisfactory level. The current study supported generally findings by Contractor et al. (2003) who showed that internationalization influences performance in long term relative to early stage of internationalization. There may be diminution in performance because of the initial learning costs, cultural and foreign market inexperience and insufficient scale of global operations. Even though this study did not evaluate the stages of performance in different period of time, performance in this study is measured for the last five years which considers time linearity.

Consistent with prior research, SMEs that have internationalized are able to create knowledge and technology skills, diversify resources and stimulate development, growth and success. SMEs could have internationalized to seek rapid growth. SMEs in Malaysia could have used systematic internationalization approaches such as motivation and strategic planning, market research, market selection, selecting the entry mode, planning for contingencies, problems and post entry strategy and commitment of resources to achieve greater heights in internationalization.

With these caveats, the present study convincingly demonstrates a deeper understanding of the Malaysian SME internationalization and their performance in the manufacturing sector. It is also able to explain the research questions well even though there are some limitations that need to be explored in future. This study clearly shows that there are some differences between the research findings in the United States, Europe and the Malaysian environments. Nevertheless, the SMEs in Malaysia have internationalized significantly as shown by the index of internationalization. Almost 60 percent of the sample scored an index of more than 60.

Policy makers need to motivate SMEs by encouraging internationalization as it increases revenue to the firm and allows SMEs to enjoy growth in the international market, especially with the implementation of ASEAN Free Trade Area (AFTA) and World Trade Organization (WTO) agreements. SMEs should take full advantage of these opportunities. Promotion programs should encourage export not only to neighboring countries (ASEAN) but also to Western and European markets. Government assisted programs also need to be tailor made to suit SMEs needs and challenges.

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Table 1. Internationalization of SMEs

	Frequency	Percentage(%)
Percentage of sales from international sources		
0%	1	1.3
1%-5%	2	2.6
6%-10%	6	7.8
11%-20%	34	44.2
21%-30%	6	7.8
31%-40%	4	5.2
41-50%	1	1.3
51%-70%	3	3.9
more than 70%	20	26.0
Total	77	100
Percentage of profits from international sources		
0%	3	3.9
1%-5%	3	3.9
6%-10%	10	13.0
11%-20%	33	42.9
21%-30%	4	5.2
31%-40%	1	1.3
41-50%	7	9.1
51%-70%	1	1.3
more than 70%	15	19.5
Total	77	100.0
Percentage of foreigners on Board of Directors		
0%	64	83.1
1%-20%	5	6.5
21%-40%	7	9.1
Total	76	98.7
Note: Missing value	1	1.3
Percentage of expatriates in the management		
0%	66	85.7
1%-20%	5	6.5
21%-40%	6	7.8
Total	77	100.0
Total number of countries exported		
1-5	32	41.6
6-10	26	33.8
11-15	10	13.0
16-20	6	7.8
21-25	2	2.6
more than 25	1	1.3
Total	77	100.0

The above Table 1.0 depicts descriptive statistics of the sample profile.

Table 2. Weightages for Index of Internationalization

Internationalization Variables	Weightage
Percentage of sales from international sources	30
Percentage of profit from international sources	30
Number of countries exported to	15
Total overseas subsidiaries and joint ventures	15
Duration in international business	10
Total	100

The above Table 2.0 depicts the weightage in building the index of internationalization.

Table 3. Index of Internationalization

Index of Internationalization	Number of respondents	Percentage (%)
less than 31	3	3.9
31-40	22	28.6
41-50	26	33.8
51-60	4	5.2
61-70	8	10.4
71-80	10	13.0
81-90	4	5.2
Total	77	100.0

The above Table 3.0 depicts the index of internationalization.

Table 4. Index of Performance

Index of Performance	Number of respondents	Percentage (%)
31-40	1	1.3
41-50	7	9.1
51-60	19	24.7
61-70	20	26.0
71-80	17	22.1
81-90	5	6.5
91-100	8	10.4
Total	77	100.0

The above Table 4.0 depicts the index of performance.

Table 5. Regression Analysis: Firm Performance

Model	Variables	Beta	t-value	Sig.	R^2	Adjusted R^2	F	Sig.
1	IOI	0.39	3.72	0.00	0.16	0.14	13.82	0.00

Note: IOI = Index of Internationalization

The above Table 5.0 depicts the results of regression analysis.

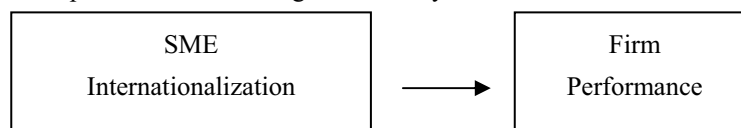


Figure 1. Internationalization and Performance of Small and Medium Manufacturing Enterprises (SMEs)

The above framework shows that the present study is examining the role internationalization towards performance.