The influence of social capital on mode and timing of entry by small and medium sized enterprises into international markets

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This paper proposes that social capital is an important factor that influences the mode and timing of entry by small and medium sized enterprises (SMEs) into international markets. Social capital is presented as a useful concept for exploring the importance of relationships on the development of internationalisation. In particular, the three dimensions of social capital – structural, relational and cognitive – as described by Naphapiet and Ghoshal (1998) are discussed in the context of developing relationships with foreign partners. The extant theories and models on the choice of entry modes are reviewed and their limitations are highlighted. The concept of social capital is then presented as a possible factor that affects the timing and entry mode chosen for internationalisation by SMEs.

BACKGROUND

The Australian government proactively encourages small and medium sized enterprises (SMEs) to internationalise their business. Through Austrade, the government offers services and assistance to SMEs, such as providing export grants, information, advice on entry modes, organises trade events and identifies overseas opportunities (Austrade, 2005). Austrade is viewed as being a connection point between Australian firms and international markets. Their mission is “to contribute to community wealth by helping more Australians succeed in export and international business” (Austrade, 2005, n.p.) and is represented in across 58 countries in 117 locations.

Despite the encouragement and incentives provided by the government only a small proportion of Australian businesses are exporting goods and services. In 2003-2004 there were an estimated 30,788 exporters, which is a mere 4% of the total number of Australian businesses (ABS, 2004). The proportion of small and medium sized businesses exporting is significantly small in number.

SMEs have different classifications across regions and countries of the world. The Australian Bureau of Statistics (ABS) defines small businesses as having fewer than 20 employees and an estimated turnover of less than $1 million, medium businesses have more than 20 and less than 200 employees and an annual turnover of less than $20 million and more than $1 million (ABS, 2004).
Of the exporting firms in 2003-04, 42% were small business (12,391) contributing 1% ($1.1 billion). Another 45% were medium sized firms (13,283) contributing 9% ($9.5 billion) (ABS, 2004). From these statistics it is apparent that the few businesses that export are gaining sound financial benefit. Therefore one queries why so few are engaging in international markets? Understanding why some businesses internationalise their markets has been the focus of much study. Most of the research has attended to the factors of market conditions in the countries of origin and destination. Some studies have investigated the factors that affect choice of entry modes and selection of countries for internationalisation. From this research, one factor is obvious – when the management of a firm decide to enter foreign markets there is usually a desire to expand the current market.

For many firms, the process of internationalisation of markets has meant embarking on a staged process. This staged process has usually involved choosing and adopting entry modes that minimise risk and allow the firm to learn how to adapt to the foreign markets (Johanson and Paul, 1975) before adopting riskier strategies. Such modes may involve exporting, licensing and foreign investment. This assumes that modes are selected in order of risk and that the firm moves to the next level of risk when they are prepared for it. This suggests a notion of timing for the development of internationalisation strategies.

Some researchers have suggested that the entry mode currently adopted by a firm can be an indication of how the firm is maturing in its foreign market. However, recently, some businesses have established that from inception, or at least been involved in exporting within the first year of operation have been involved in foreign markets. These firms are called ‘born-global’ firms. The establishment of these firms has challenged the notions that firms adopting modes of entry in a staged approach with the development of sound domestic markets first and then internationalise. Furthermore the notion of timing is challenged.
A possible explanation for the discrepancy between theory and what has occurred in the marketplace is that the theory has focused on the level of the firm rather than the level of the individuals within the firms. The extant literature does recognise that experience is an important factor for the internationalisation process. However it has been assumed that the experience is necessarily firm centric rather than possessed by individuals. This paper aims to offer an alternate view that it is the social capital held by individuals in the firm that determines modes of entry and the timing of internationalisation processes. The main proposition of this paper is that

*Social capital is a major factor in determining mode and timing of entry by a SME into foreign markets.*

The paper contains three sections. The first section describes the concept of social capital. The second section reviews the internationalisation literature to highlight the limitations of previous theories and models. The third section describes the relevance of social capital as a concept to investigate the choice of entry modes and timing of internationalisation by SMEs. The final section

**SOCIAL CAPITAL**

Social capital is an umbrella term used to describe the value of relationships that are held between individuals when leveraged to gain economic advantages for the firm. According to Burt (1995) the concept of social capital was conceived to explain the value of an individual or an organisation’s social relationships. These relationships can significantly effect future business development and dependency between the individual or the organisation and those to whom the social capital is shared. Social capital can be leveraged to provide the organisation with a network of connections that benefits the company’s economic capital, including resources such as material, information, market opportunities and status.
The concept of social capital as described by Naphapiet and Ghoshal (1998) has three dimensions – structural, relational and cognitive. Although these dimensions can be described as possessing different sets of characteristics and be variable, the dimensions are highly interrelated and complement each other. Social capital is the sum of the dimensions that determines its’ utility and malleability to the context to which it is to be applied. In this paper the context is the expansion of marketing into foreign markets.

The structural dimension of social capital refers to the structural configuration of ties (i.e., relationships) between individuals. Such ties are used to identify individuals with desired knowledge who are in the network (Lesser and Cothrel, 2001), and enables access to the people and their knowledge resources (Hazleton and Kennan, 2000). This dimension is influenced by such things as: network density, connectivity, and referrals.

Network connectivity is the degree to which actors within a network can interact. Network ties function as a medium for developing shared customs, values, attitudes and standards of behaviours (Andrews, Basler, and Coller, 1999). An individual with a high number of network ties will have access to a greater number of resources and a wider variety of influences. An associated concept is the centrality of an individual. Central actors often have a high number of network contacts spanning disparate groups. It is a powerful position as they are situated at a confluence of relationships and are best situated to influence the behaviours and attitudes of others (Andrews et al., 1999).

The relational dimension refers to various social dynamics including trust, shared norms, interpersonal obligations and expectations. Arenius (2002: 64) stated that “social capital exists in a relationship between two actors if they develop personal bonds, attachment and trust.” Perry, Cavaye, and Coote (2002) identified some core attributes of relationship bonds. They found that trust, commitment, equity, conflict resolution, and benevolence shaped the relationships within an interorganisational network. An individual is more likely to commit to
a relationship if they perceive the existence of trust and benevolence. Moreover, a sense of equity (sharing of benefits and costs) will result in increased trust and decreased conflict. Thus, the formation of effective and stable relationships relies on these relational dimensions.

Likewise, Arenius (2002) found that the relational dimension was evident in patterns of behaviour. This includes the willingness and capacity to cooperate and coordinate. Furthermore, the relational dimension encompasses embedded network resources such as reputation, credibility and trustworthiness. These attributes are used by network members to express others’ patterns of behaviour.

The cognitive dimension refers to the possession of a shared context. It has also been referred to as a shared thinking and language, values, experience, and culture (Nahapiet and Ghoshal, 1998; Snowden, 2002). Arenius (2002), provides an expanded definition, in which the cognitive dimension includes shared representations, interpretations, and systems of meaning embodied in shared codes, languages and narratives. A shared context can both assist in the emergence of social capital and enable access to and utilization of resources. The cognitive dimension (along with the relational dimension) is an indicator of the quality of a relationship (Arenius, 2002).

Context does not refer to a fixed set of surroundings but an extensive dynamic process (Augier, Shariq, and Thanning Vendelo, 2001). Context is created from our knowledge, experience, understanding, desires, practical interests, values, emotions and culture (Augier et al., 2001; Heyman, 1994; Malhotra, 2001; Snowden, 2002). It is both constructed through the process of interpretation (Augier et al., 2001; Heyman, 1994) and used to interpret new situations (Augier et al., 2001). The cognitive dimension is required to make sense of the knowledge exchange. It serves to reconstruct meaningful representations of the knowledge so that it retains the necessary context for the knowledge to remain useful. Shared contexts
resultant of the cognitive dimension provide meaningful communication that enables the exchange and combination of knowledge between and within the subjects.

**LITERATURE REVIEW OF ENTRY MODE CHOICE**

The issue of market entry choice has become the focus of numerous theories and models. These have been developed to explain and contribute toward our understanding of associated phenomena. Five approaches have been emphasised in previous studies. They are (1) the stage development model (Johanson and Paul 1975; Brooke, 1986), (2) the transaction cost analysis model and extensions (Williamson, 1975, 1979, 1985; Buckley and Casson, 1976; Casson, 1982; Caves, 1982; Anderson and Gatignon, 1986; Kogut and Singh, 1988; Erramilli and Rao, 1993), (3) Ownership, Location and Internationalization model (Hymer, 1960, 1976; Kindleberger, 1969; Franko, 1971; McManus, 1972; Stopford and Wells, 1972; Buckley and Casson, 1976; Vernon, 1977; Dunning 1977, 1980, 1988, 1995, 1998, 2000), (4) the organisation capacity model (Aulakh and Kotabe, 1997; Madhok 1998) and (5) the decision making process (Root, 1994; Young, Hamill, Wheeler and Davies, 1989). Many empirical studies have been conducted to test the validity of the extant theories and models.

The stage development model (Johanson and Paul, 1975) specifically investigates the internationalisation strategies of SMEs. The model asserts that the internationalisation of SMEs is an incremental process that evolves over a long period. Two factors are featured in the model, which include cultural expansion and commitment. Brooke (1986) applied the stage development model to explain market entry mode decisions. He concluded that entry mode is dependent on the firm’s development stage. The development stage models has limitations, nonetheless is its incapacity to explain why some firms commence with wholly owned ventures and do not or have not exported.

The transaction cost analysis (Anderson and Gatignon, 1986) is based on transaction cost economics, which is a tool used to explain economic problems where asset specificity plays a
role. The framework purports that entry modes are assessed by the level of control the organisation has against the level of risks and uncertainty of the intended markets. Other researchers (Anderson and Weitz, 1986; Hill, Hwang and Chan, 1990; Klein, Frazier and Roth, 1990; Erramilli and Rao, 1993, Lu, 2002, Brouthers, 2002) extended the framework and have found great support for it. Despite the many insights offered by the framework it has limitations, in that the transaction costs are difficult to measure and thus offers little implications for managers.

Ownership, location and internationalisation model states that entry mode decisions are determined by the possession of three advantages by the enterprise. The three are ownership advantage (those specific to the nature and nationality of the owner), internationalisation advantages (that arise from transferring ownership across national borders within the one organisation), and location advantages (that arise from the different costs of production associated with different locations). Although the theory has been supported through empirical studies (Agarwal and Ramaswami, 1992), it is limited in that it neglects to consider competition, strategic factors, characteristics and the situation of the decision maker.

Aulakh and Kotabe (1997) and Madhok (1998) adopted organisational theory to develop the organisation capacity model. From this perspective the firm is a vessel of capabilities and knowledge comprised of individual skills, organisational structure, organisational culture and technology that is inextricably woven (Nelson and Winter, 1982). This model makes important contributions in that the capacity of the organisation to deploy resources to international market is considered as a factor in determining entry mode choice. However a major assumption of the model, which is also a limitation, is that the capacity of the firm is limited to ownership. This ignores the significant influence that collaborative agreements may have on changing the capacity of the firm. Furthermore the model does not consider the impact that the decision maker has, or the sociological or political factors.
Root (1994) proposed the decision making process model, which is developed by Young et al. (1989), Kumar and Subramaniam (1997), Pan and Tse (2000) and Eicher and Kang (2002). According to the model entry mode choice is a multistage decision making process that can be optimized by taking into account the existing environment, the objectives of the intended market entry and the associated risks and costs. It focuses on the decision making rather than the impact that the factors might have in affecting the entry mode choice. It does however ignore the role of the organisation and the decision maker within the process.

In summary, although each of the models discussed above have contributed to the identification and understanding of the factors that influence entry choice mode they have limitations. The staged development model does not explain why some firms can start internationalisation with foreign direct investment or licensing without exporting. The transaction cost analysis is difficult to measure and does not connect with corporate governance. The ownership, location and internationalisation model, organisational capacity model and the decision making process model ignore the impact of the decision maker. In addition the ownership, location and internationalisation model does not consider the impact of the firm objective and the situational contingencies that surround the decision maker. The organisational capacity model also ignores the social and political environment.

THE RELEVANCE OF SOCIAL CAPITAL IN INTERNATIONALISATION

The authors of this paper suggest that the theories and models presented have limitations that are derived from the problem of defining an appropriate unit of analysis for investigating entry mode choice. Most of the theories are focused at the organisational level and then include factors from sub-levels (e.g., decision maker, capabilities and capacity of employees) and/or the market level (e.g., market competition and country characteristics – political, economic and cultural). We assert that they overlook the importance of relationships. We do not suggest that they have ignored the relationships, as the ownership, location and internationalisation model does consider the nationality of the owner which implies that
he/she may have connections with the country of interest. However, we believe that the relationships that organisational member have deserve greater attention. The relationships that members of the organisation hold with entities outside the firm that can determine future success of the firm, particularly in the international context. This is particularly relevant to SMEs where resources are often scarce and there is a constant need to find external capacity and capabilities to embark on new business ventures.

The remainder of this section redresses the limitations presented in the previous section and illustrate how social capital can accommodate for the limitations of previous models. Firms that start the internationalisation process with foreign direct investment or licensing without exporting must have employees or relationships with those outside the firm that have the appropriate experience to be involved with these later stages. The experienced employees would usually bring the necessary social capital to the position, through the maintained relationships with those they have previously done business. Social capital is potentially easy to identify and can be measured. Previous studies have measured aspects of social capital drawing on network theory (Andrews et al., 1999) and studies of trust and commitment (Morgan and Hunt, 1994). The use of social capital accounts for the impact of the corporate governance and the impact of the decision maker, because individuals who hold the social capital choose whether or not they will exercise it for the benefit of the firm. The decision of the individuals who possess social capital is contingent on the circumstances and their perceived position in the firm and benefits derived from using the social capital. With the social capital framework the social and political environment determines how effective the use of social capital can be. Therefore social capital is dependent on all the factors which the other models have tended to ignore, and subsequently the social capital framework is useful for investigating the factors that affect entry choice mode and timing of internationalisation processes.
Finally, this section can be concluded, by stating that the relevance of social capital in relation to SME’s internationalising, suggests: individuals choice of entry mode is most likely to be dependant on the extant of the social bond (social capital) developed between these SME’s.

This is derived from the evidence presented earlier in this paper, which suggested that social capital required in a network, is dependant on the right mix of structural, relational and cognitive dimensions cognizant of the organizational context (Whittaker and Van Beveren, 2004)” Therefore the research intend to suggest that the “three dimensions of social capital develop only after repeated and active social interactions over a period of time (Vinding, 2002). Where the relevance of these three dimensions all play a very important role in choice of entry mode, as good social capital between SME’s from differing countries poses as the foundation of their relational framework.

Optimistically this framework is expected to develop a good relationship between individuals, as ultimately SME’s exploring international partners will incorporate trust, commitment and disengagement (Whittaker and Van Beveren, 2004).

CONCLUSIONS
This paper has presented the concept of social capital to the field of international marketing and the investigation of entry mode and timing of internationalisation by SMEs. The main proposition of the paper is that social capital is a major factor in determining mode and timing of entry by a SME into foreign markets. We assert that the concept of social capital offers a useful framework for investigating what we purport to by the key aspect of internationalisation – relationships. The perspectives from which the extant theories have
been developed, have contributed to the narrow scope of the models presented. This paper provides an alternative perspective that may be used in conjunction with the other perspectives. We do not suggest that this framework will cover all aspects of the decision making process or the factors considered by managers. It certainly does not consider directly the economic or political factors pertaining to the proposed target countries. Rather this framework sets these and other factors in the context of relationships where the factors can be evaluated and perhaps addressed with the consideration of collaboration and with the inside knowledge of potential partners that share the social capital.

The intention of this paper is to offer academicians and managers with a framework that considers the role of individuals in the decision making process and the dynamics of relationships. It is our intention that in presenting these arguments we will have encouraged researchers to investigate further the role of social capital. It is our intention to validate the proposition of this paper through further research and then to apply measures of social capital that have been developed in other contexts to the context of internationalisation by SMEs.

The framework offered in this paper is consistent with the mission and suggested role of the Australian government and in particular Austrade. A contribution of further research from the perspective offered might be to inform government with regards to how they can best encourage SMEs to internationalise by providing better services to develop and enhance social capital rich networks.
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