

Development of institutional knowledge during the internationalization process of SMEs from an emerging economy

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Abstract

Changes in the business environment have pressed the internationalization of *small and medium enterprises* (SMEs) in emerging economies.

This study contributes to the understanding of the internationalization process of exporting SMEs by analyzing the effects of experience on institutional knowledge in foreign markets. The development of institutional knowledge allows firms to create new opportunities and enhance their continued growth and their position in these markets.

The sample consists of 200 exporting SMEs from fast growing emerging South American economies: Chile and Peru. Hypotheses are tested using Structural Equation Modeling (SEM). The results show that the “ongoing business experience” and “country experience” have a positive influence on the “development of institutional knowledge” in the internationalization process of the SMEs, while “international experience” does not show an effect on the development of institutional knowledge. Our study contributes to improve our

understanding of how international entrepreneurial SMEs utilize overseas opportunities for achieving in third markets.

Keywords: Country Experience, International Experience, Institutional Knowledge, Ongoing Business Experience, SMEs, South America.

1. Introduction

Structural changes in markets, the dynamic pace of globalization and technological discoveries have led to significant changes in the competitive behavior of small and medium enterprises (SMEs). This has caused a significant increase in the number of SMEs around the world that have international operations (Belso-Martinez, 2006). That is why internationalization has become important in the growth strategy of the firms in recent years (Etemad, 2013, 2016; Felzensztein et al., 2013a; Pino, Felzensztein, Zwerg-Villegas, & Arias-Bolzmann, 2016)

The important contribution made by SMEs to employment and economic dynamism in industrialized countries suggests that these firms may also contribute to sustainable development in emerging economies (Etemad, 2013; Felzensztein, Ciravegna, Robson, & Amorós, 2015; Meyer & Peng, 2016). However, by increasing competition and reducing some government subsidies, a growing number of SMEs have been pushed into internationalization in emerging economies (Etemad, 2013). As they expand to international markets, SMEs are faced with a number of limitations in different areas including finance, information, experience, knowledge and contacts, which restrict their internationalization process (Buckley & Ghauri, 1999; Chetty & Campbell-Hunt, 2003).

Knowing which factors have an influence on the internationalization of SMEs in emerging economies is relevant on the strategic position of the firms in foreign markets (Etemad, 2013). The experience of the firm in its foreign markets allows the development of specific knowledge about its environments (Kogut & Zander, 1992; Zahra et al., 2000). When the firms know more on the institutions located in markets, organizations and foreign governments, they can decrease the perceived uncertainty in its specific market of operation and explore new opportunities (Forsgren, 2002). The combination of the experience and learning that the firm achieves on institutional conditions in international markets allows to create opportunities of value for the firm (Johanson & Vahlne, 2006; Zahra et al., 2000).

The purpose of this study is to understand and analyze the effects of the different types of experience of SMEs on the “development of institutional knowledge” during its internationalization process. The main question is: Which types of experiences on international markets generate an important effect on the development of institutional knowledge in SMEs?

Our sample comprise exporting SMEs from the fast growing South American emerging economies: Peru and Chile. These countries have a similar colonial, language and economy history. Regarding to the last, they moved from being protectionist closed markets to liberalized market economies (Dominguez & Brenes, 1997). Results show that the “ongoing business experience” and “country experience” have a positive influence on the “development of institutional knowledge” in the internationalization process of SMEs, while that International Experience does not impact the development of Institutional Knowledge. Our results provide useful new knowledge.

2. Literature and theoretical model

The literature associated with internationalization process of SMEs proposes two theoretical approaches; accelerated and gradual internationalization process when the firms develop business operations in foreign markets.

Uppsala model considers that the process of internationalization of SMEs is a gradual commitment of the firm with foreign markets (Johanson & Wiedersheim, 1975, Johanson & Vahlne, 1977). According to Johanson and Vahlne (1977) experiential knowledge takes an important role in reducing the uncertainty associated with the commitments acquired by the firm in overseas markets.

It is also well known that SMEs have limited resources and scarce business skills that make them more vulnerable to changes in the environment and restrict their international expansion (Chetty & Campbell-Hunt, 2003). In addition, SMEs have little knowledge about

foreign markets, and this is especially evident for SMEs located in Latin America (Felzensztein et al., 2015). This is why it is highly likely that these firms choose to gradually establish international operations in a limited number of countries rather than accelerate its internationalization process. Therefore, the decision over which country they will focus their efforts on is key to ensuring long-term success in the internationalization process (Ellis, 2000; Etemad, 2015).

In the internationalization process, foreign market knowledge is acquired through the contact and collaboration with others who have this understanding (Chetty & Blankenburg Holm, 2000; Lindstrand et al., 2009, 2012). This knowledge arises from a specific and unique relationship between a firm, its foreign partner and their business networks (Anderson et al., 1994; Eriksson & Chetty, 2003). So as the firm proceeds with its internationalization process, it learns to accumulate experiential knowledge of foreign markets (Cohen & Levinthal, 1990; Etemad, 2013; Johanson & Vahlne, 1977).

There is evidence that experience improves the firm performance on foreign markets. Firms develop experience in the specific markets in which they operate. This experience allows for the development of institutional experiential knowledge (Eriksson et al., 2004).

Institutional knowledge is the understanding that relates to institutions located in markets, organizations and foreign governments. Furthermore, it is defined by the way in which these institutions work (Chetty et al., 2006). Institutions are the game rules of social context for interaction between individuals or organizations (North, 1990). Institutional knowledge is characterized by the fact that it can be encoded in laws and regulations, as well as it can be learned only from experience (Chetty et al., 2006; Grant, 1996). Therefore, institutional knowledge is the knowledge originating in the formal and informal institutions interacting in society (Eriksson, 2004).

The experience of the company in foreign markets results in the development of specific knowledge, which leads the firm to commit resources in their internationalization process (Johanson & Vahlne, 1977; Kogut & Zander, 1992; Zahra et al., 2000). The commitment of

resources that a company allocates towards an international engagement with a specific business partner in a given market, it is called "*ongoing business*". An ongoing business is considered a business relationship where there is a long-term commitment of resources between a company and its specific counterpart.

This study considers three types of experiences: (1) "ongoing business experience", (2) "country experience" and (3) "international experience". "Ongoing business experience" refers to the experiences that the firm has gained in one specific resource commitment with a counterpart in a specific country. "Country experience" considers a group of experiences acquired from multiple business in one country. "International experience" considers previous multiple experiences in different foreign markets (Eriksson et al., 1997; Chetty et al., 2006; Lindstrand et al., 2012).

The experience that a company gains through an ongoing business is determined by the unique relationship that is established with its counterpart SME during the internationalization process (Anderson et al., 1994; Blankenburg Holm et al., 1996; Chetty & Blankenburg Holm, 2000). This relationship is structured, based on experiential learning that results in the adaptation between partners and their networks (Johanson & Vahlne, 1977; Globerman & Shapiro, 2002; Eriksson & Chetty, 2003). This adaptation process increases the importance of institutional knowledge for the SME that chooses to internationalize its operations (Chetty et al., 2006).

Based in this literature, we proposed:

H1: The more experience that a SME has in an ongoing business, the greater the perceived importance of institutional knowledge is to the SME.

As the SME participates in multiple businesses in the same country, it develops a certain expertise on that specific market. Simultaneously, the SME builds knowledge which is critical for the success it can achieve in its internationalization process in that country (Agndal et al., 2008; Eriksson & Chetty, 2003; Johanson & Vahlne, 1977; Hitt et al., 1997).

This knowledge corresponds to the SMEs institutional knowledge acquired from a specific country (Chetty et al., 2006).

Then, we propose:

H2: The more experience gained by multiple businesses of the SME in a certain country, the greater the perceived importance of institutional knowledge in the SME.

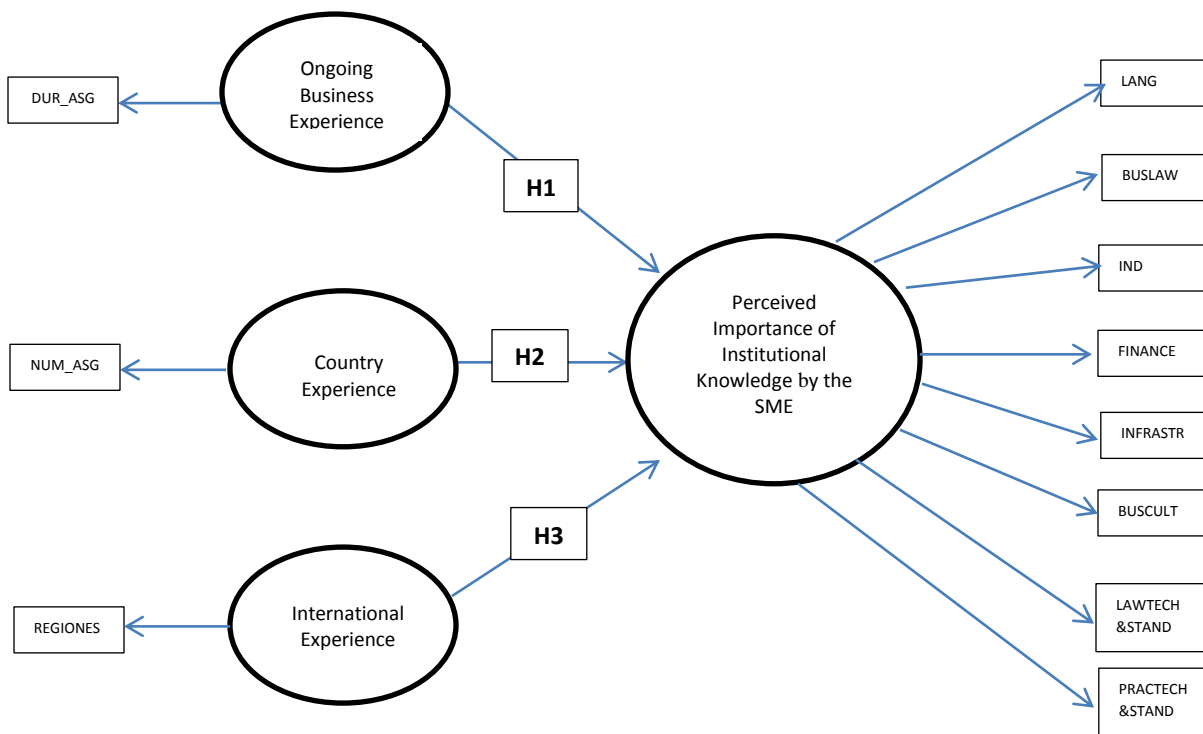
When the internationalization process of the SME is conducted in several countries, the company develops a much more integral understanding of the spectrum of environments of countries with which it is linked (Johanson & Vahlne, 1977; Chetty et al., 2006; Etemad, 2013; Felzensztein et al., 2013b). This way, the more international experience a company acquires, the more institutional knowledge it develops and collects (Eriksson & Chetty, 2003; Chetty et al., 2006).

Therefore, we propose:

H3: The more international experience that a SME has from previous multiple businesses in various regional markets, the greater the perceived importance of institutional knowledge in the SME.

Our hypotheses are presented in the theoretical model (**Figure 1**).

Figure 1: Theoretical Model



Our model relates the dependent variable "perceived importance of institutional knowledge in the SME" with the independent variables "ongoing business experience", "country experience" and "international experience".

The importance of knowledge associated to the business law, business culture and financial practices in the foreign markets (Chetty et al. 2006), can be complemented with the knowledge regarding industry structure, infrastructure, laws and practices on technology and quality standards (Asheim & Coenen, 2006; Eriksson et al., 1997; Javernick-Will & Levitt, 2009). This with the aim of providing a more comprehensive vision for the analysis of the development of institutional knowledge in exporting firms in the South American context.

The construct "perceived importance of institutional knowledge in the SME" allows us to capture the lack of institutional knowledge in the SME as a factor that represents an obstacle for conducting international business. This construct is measured by eight observable variables:

- The firm's perceived lack of knowledge about business law (BUSLAW).

- The firm's perceived lack of knowledge of business culture (BUSCUL).
- The firm's perceived lack of knowledge about financial practice (FINANCE)
- The firm's perceived lack of knowledge of language (LANG).
- The firm's perceived lack knowledge about industry structure (IND).
- The firm's perceived lack of knowledge of infrastructure (INFRASTR).
- The firm's perceived lack of knowledge about laws on technology, products and quality standards (LAWTECH&STAND).
- The firm's perceived lack of knowledge of practices on technology, products and quality standards (PRACTECH&STAND).

3. Methodology

3.1. Sample and data

The empirical analysis is based on data collected from exporting firms in Peru and Chile. These exporting firms have no foreign subsidiaries. This survey was conducted in Spanish (local language) during 2014-2015. It took 7 months for collecting firm level data in the two South American countries. The survey includes 3 sections with 22 individual questions about general information of the firms, measurements of “experiences”, measurements of “perceived importance of institutional knowledge” for the exporting SMEs.

The respondents were managers or assistant managers in charge of international operations of exporting SMEs from Peru and Chile.

In Chile, the surveys were applied to member firms of the Export Promotion Agency (PROCHILE). The surveys were also applied to exporting firms members of different trade associations: aquaculture (*Asociación de la Industria del Salmón en Chile SALMONCHILE*, *Asociación Mitilicultores de Chile AMICHILE*), mining (*Sociedad Nacional de Minería, SONAMI*), wines (*Vinos de Chile*), and fruits (*Asociación de Exportadores de Fruta de Chile, ASOEX*).

In Peru, the surveys were applied to exporting firms in the exporters association: *Asociación de Exportadores (ADEX)*, which is a non-for-profit trade association with the

purpose of promoting peruvian exports in sectors such as tourism, mining, fishing, manufacture and services, among others.

The cross section data was compiled from exporting SMEs associated to these institutions in each country. Our empirical analysis is based on a sample of 200 firms from Chile and Peru. The response rate was 12.2% in Chile and 13.5% in Peru.

3.2. Measurement

The survey asked respondents to rate their perceptions regarding to the “Perceived Importance of Institutional Knowledge”. This construct is measured through observable variables on a seven-point likert scale (1= completely agree, 2= agree, 3= partially agree 4= indifferent, 5= partially disagree, 6 = disagree, 7= completely disagree). In contrast, the variables "ongoing business experience", "country experience" and "international experience", are measured in terms of whole-number quantities, which is why a logarithmic transformation is applied to adjust the measurement scale used to measure the dependent variable.

Our sample of 200 exporting firms are from Chile (49.5%) and Peru (50.5%). It includes small businesses (66.5%) and medium size businesses (33.5%). 79% of the firms generate products. Additionally, the main sector in the sample is manufacture with 49%, most companies were born after 1990 (young firms) with a 69% of the sample, and, the main legal status of the firm is closed anonymous society (privately owned firm) with 54%. More details on the characteristics of the sample are presented in **Appendix B**.

3.3. Multivariate analysis

The procedure for analyzing the data had two stages:

- First, Exploratory Factor Analysis (EFA) and Confirmatory Factor Analysis (CFA) were conducted for testing the reliability of the construct “perceived importance of institutional knowledge in the SME” and testing the model fit (Hair, 2010; Byrne, 2010). For each analysis we use SPSS 20 and AMOS 20, respectively.

- Second, Structural Equation Modeling (SEM) in AMOS 20 was used to test the proposed model and hypotheses (Byrne, 2010; Hair, 2010).

We did an Exploratory Factor Analysis (EFA) to determine the assignment between the construct and their observable variables. We conducted a Confirmatory Factor Analysis (CFA) to measure the model fit with the following indicators: CMIN/df, GFI, NFI, CFI, RMSEA and AGFI. Each indicator must be between a minimum and a good fit level (Table 1).

4. Results

According to the indicators of model fit for the measurement structural model, such as: CMIN/df, GFI, NFI, CFI, RMSEA and AGFI (Table 1 and Table 2). These indicators allow us to confirm that our scale provides good means for measuring these phenomena.

Table 1. Confirmatory factorial analysis for the structural model.

Model Fit	CMIN/df	GFI	NFI	CFI	RMSEA	AGFI
Model	1.403	0.961	0.959	0.988	0.045	0.928
Minimum	$2 < x < 3$	0.90	0.90	0.95	$0.05 < x < 0.1$	$x > 0.80$
Good	$x < 2$	0.95	0.95	0.99	$x < 0.05$	$x > 0.85$

For the structural model, the indicators show that there is a good fit model. All indicators show good fit levels CMIN/df, GFI, CFI, NFI, RMSEA and AGFI (CMIN/df =1.403, GFI = 0.961, NFI = 0.959, CFI =0.988, RMSEA = 0.045 and AGFI =0.928).

In relation to the hypotheses (Table 2), the analysis concludes that:

Table 2: Summary of Hypotheses and structural model path coefficients.

Hypothesis	Path	Estimate	SE	P	Result
H1	Ongoing Business Experience-Perceived Importance of Institutional Knowledge	0.907	0.461	0,049	Supported
H2	Country Experience-Perceived Importance of Institutional Knowledge	0.780	0.377	0.039	Supported
H3	International Experience- Perceived Importance of Institutional Knowledge	-0.887	0.476	0.062	Not Supported

5. Conclusions

This research contributes to the international entrepreneurship field by exploring the influence of different types of experiences in foreign markets on the development of institutional knowledge for the exporting SMEs in the South American emerging economies. To our knowledge, there are no previous studies that examine this relationship in Latin American context. To analyze these effects is key for a consolidation of the business internationalization process of the SMEs in emerging economies.

The main conclusions of our study are the following:

1. Our findings show that the development of institutional knowledge can be measured by additional variables for exporting firms in South American emerging economies. These variables are associated to conditions about industry, infrastructure, law and practices on technology, products and quality standards, that exist in foreign markets for exporting firms. In South American emerging economies, the road and basic services infrastructure is still important for the exporting firms in logistic terms. Likewise, the characteristics, laws and public policies for specific industries are very relevant in SMEs with operations in foreign markets. Also, the quality management and intellectual property management for protecting and using products/technologies are keys in the internationalization process for South American exporting SMEs, specially, when they export to develop countries.
2. Our findings confirm that the development of institutional knowledge in exporting SMEs from Peru and Chile depend of experiences (one or multiple businesses) that the firm develops in one country. The firms need to advance step by step for developing knowledge regarding a foreign market through two ways, first one business in one country where the firm generates an engagement of resources with its partners on the medium and long term. Second, the exporting firm establishes multiple businesses in a same country. The importance of the development of institutional knowledge for the exporting firms is that they can decrease the levels

of uncertainty in its foreign markets and enhancing their continued growth and their position in these markets.

This study explains the internationalization process of exporting SMEs in Peru and Chile by the integration of experience and development of institutional knowledge on its international markets in the South American emerging contexts. Institutional knowledge plays a key role in the internationalization process for exporting SMEs, because they have limited resources for this process. The development of institutional knowledge allows firms to create new opportunities for themselves in their markets.

The results of this study can guide strategic decisions of managers in companies to achieve better positioning in their foreign markets. Similarly, the results could guide strategic decisions of policy makers, because the governments of Chile and Peru have an important focus in the export promotion of their different economic sectors.

Regarding the limitations of this study, our findings are based on measurements at a cross sectional level rather than as a longitudinal assessment and, thus, this does not reflect the dynamic nature over time of the phenomena under analysis.

The future researches could consider other countries from Latin American emerging economies such as Mexico and Colombia, both members of the Pacific Alliance. We also propose to analyze by economic sectors or age of the firm in larger samples with other Latin America countries. This will give us a much more complete and integrated view regarding the influence of different types of experiences on the development of institutional knowledge in exporting firms from Latin American emerging economies, specially, when the firms establish international operations in a global highly dynamic context.

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APPENDIX B

Table B.1: The sample

Country	Number of Firms	Percent
Chile	99	49.5
Peru	101	50.5
Total	200	100

Table B.2: Characteristics of the Sample (total)

		Sample	
		Frecuency	Percent
Type of Firm	Productive	158	79.0
	Service	42	21.0
Sector	Mining	14	7.0
	Aquaculture and fisheries	19	9.5
	Turism and Services	16	8.0
	Agroindustry (viniculture, fruit, etc.)	42	21.0
	Financial services and outsourcing	11	5.5
	Manufacture	98	49.0
Age of firm	Before of 1980 (old)	26	13.0
	Between 1980-1990	36	18.0
	After of 1990 (young)	138	69.0
Size (N° of employees)	Between 10-50 (small)	133	66.5
	Between 51-200 (medium)	67	33.5
Legal Status of the Firm	Individual Person	8	4.0
	Individual Entrepreneur Limited Responsibility(E.I.R.L.)	18	9.0
	Society with Limited Responsibility (S.R.L.)	38	19.0
	Open Anonymous Society	26	13.0
	Closed Anonymous Society	108	54.0
	Collective Society	2	1.0
Total		200	100

Table b.3: Characteristics of the Sample (by country)

		Chile		Peru	
		Frecuency	Percent	Frecuency	Percent
Type of Firm	Productive	63	63.6	95	94.1
	Service	36	33.4	6	5.9
Sector	Mining	12	12.1	2	1.9
	Aquaculture and fisheries	11	11.1	8	7.9
	Turism and Services	15	15.1	1	0.9
	Agroindustry (viniculture, fruit, etc.)	20	20.2	22	21.8
	Financial services and outsourcing	9	9.0	2	1.9
	Manufacture	32	32.5	66	65.6
Age of firm	Before of 1980 (old)	11	11.1	15	14.8
	Between 1980-1990	14	14.1	22	21.8
	After of 1990 (young)	74	74.8	64	63.4
Size (N° of employees)	Between 10-50	64	64.6	69	68.3
	Between 51-200	35	35.4	32	31.7
Legal Status of the Firm	Individual Person	8	8.1	0	0
	Individual Entrepreneur Limited Responsibility(E.I.R.L.)	8	8.1	10	9.9
	Society with Limited Responsibility (S.R.L.)	30	30.3	8	7.9
	Open Anonymous Society	9	9.1	17	16.8
	Closed Anonymous Society	42	42.4	66	65.4
	Collective Society	2	2.2	0	0
Total		99	100	101	100