

# MANAGEMENT & ACCOUNTING REVIEW

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# Exploring the Impact of the Political Environment and National Culture on Readiness for Internationalization in SMEs

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## ABSTRACT

*The purpose of this study is to examine the influence of the political environment and national culture on readiness for internationalization. The Smart-Partial Least Squares (PLS) analysis was used as to investigate the research model based on a survey of 60 Small and Medium-sized Enterprises (SMEs) from various industries which included companies in pharmaceutical, technological, electronic and foods and beverages industries in Klang Valley, Malaysia. The results supported the effects of two exogenous variables towards the endogenous variable (Internationalization Readiness). Since the samples were limited to some SME companies in Klang Valley, Malaysia, the results of this study can only achieve theoretical generalization. Statistically, this study may prove not to be generalizable to the sample and should be confirmed using larger samples.*

**Keywords:** *Internationalization readiness, Political environment, National culture, SME*

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## INTRODUCTION

The increasing internationalization of Small and Medium-sized Enterprises (SMEs) has been reflected in a growing academic interest in understanding the nature of such activity. The growing body of research aimed at understanding the nature of the internationalization for SMEs suggests that the unique characteristics of such firms, particularly their resource constraints and timing of entry into the international marketplace, export barriers and dealing primarily with large multinational organizations (Dickson, Weaver and Vozikis, 2013). The most widely explored theories of internationalization in business research that have also been applied in SMEs, are those labeled as the “stage” theories of internationalization or the “Uppsala Model” developed by Johansson and Vahlne (1977). Johanson and Vahlne (1977) suggest that firms will move first into international markets that are most like their home markets and then with time and knowledge acquisition will take increasingly greater risks in entering markets that are more distant or more dissimilar to their home markets. Hamidizadeh and Zargaranyazd (2014) argued that the concept of internationalization readiness has rarely been the focus of research efforts which until a decade ago, focused principally on explaining sequences of entry modes and choices of market. Furthermore, there are quite extensive studies on internationalization, Hennart and Slangen (2015) argued that since the global environment of doing business is dynamic, they call for more research on internationalization specifically on entry mode studies. Thus, the primary goal of this study is to investigate the influence of the political environment and national culture on internationalization readiness. Other than that, this study also aimed to investigate which exogenous variable could influence the most toward internationalization readiness.

## LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

### Internationalization Readiness

Internationalization readiness can be defined as “the process of integrating an international, intercultural or global dimension into the purpose, functions or delivery of post-secondary education” (Knight,

2003). At present, most researchers agree that internationalization is not a universally defined concept and cannot be completely explained by any single theory. Other than that, internationalization readiness can be defined as the process in which a firm widens its operations from domestic markets to foreign markets by adapting its strategies, structures and resources to the international environment to improve its overall performance (Idris, Saad & Mohamed, 2014). A host of scholars believe that internationalization leads to improved performance of SMEs (Idris, Saad & Mohamed, 2014; Lu & Beamish 2006) although this may not be true for all dimensions of performance. Generally, internationalization is an interesting discipline to be discovered. Many countries dealt in continuing international business with foreign markets. This phenomenon is very pronounced today and opens interesting opportunities for research into international expansion strategies, especially the internationalization trials of small and medium enterprises (SMEs). Filling this gap would help to understand the internationalization process more accurately. Furthermore, as noted by Federico, Kantis, Rialp & Rialp (2009), there is a lack of research into internationalization in emerging countries.

## **Political Environment**

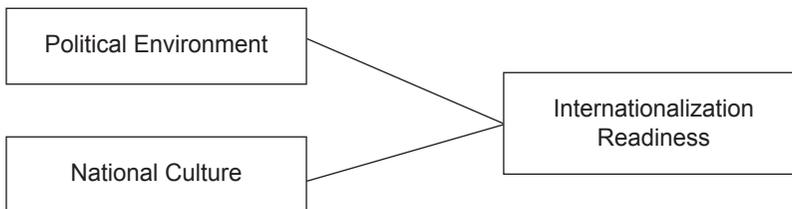
The political environment includes the political situation of the target country, the government's use of authority as well as the policies and bureaucracy matters. The legal environment consists of the legal system of the target country. A high level of technical legislation as well as its predictability and professional applicability are matters which generate trust towards the target market. The domestic political and legal environment includes all political and legal issues, which influence the international business of a company, such as the government's actions for internationalization activity whereas the political and legal environment of the target country consists of issues which concern the company as it operates in that specific market. According to Oviat *et al.* (2004), the political environment has a significant relationship towards internationalization. Other than that, environmental characteristics in the form of political, economic, social, technical, and legal requirements at home and in the target country also have a significant relationship with the internationalization process (Senik, Isa & Ayob, 2014).

**H1:** There is a positive relationship between the Political Environment and Internationalization Readiness.

## National Culture

The culture of nation or psychic distance in country is defined as the differences that exist between the value systems of different regions or countries. According to Tihanyi *et al.* (2005) the differences, which exist between the culture of a firm's home country and the culture of its target location, are positively linked to the internationalization process. The cultural difference is an important aspect to be further studied given the intense internationalization in the international market. In the Dow and Karutnaratna (2006) study was developed and tests a range of potential psychic distance stimuli including differences in culture, language, religion, education and political systems on export, internationalization, joint ventures and subsidiaries.

**H2:** There is a positive relationship between National Culture and Internationalization Readiness.



**Figure 1: Research Conceptual Framework**

## RESEARCH METHODOLOGY

This is a quantitative study which involved numerical analysis. The study used the SmartPLS software to analyze the data. Surveys were distributed by using a questionnaire as the instrument to measure all variables. Time horizon was cross-sectional because it involved the collection of data from a sample once only. Self-administered questionnaires were used to collect data from SME companies' employees. A 5-point Likert scale ranging from 'strongly disagree' to 'strongly agree' was used to measure the variables

in this study. The survey items to assess respondents' Internationalization Readiness were adopted from the Department of State Development Business and Innovation (2013) by using six items. Perceptions of the Political Environment (three items) and National Culture (four items) were also adopted from the Department of State Development Business and Innovation (2013). A total of 60 SMEs participated in the survey. These include companies from the pharmaceutical, technological, electronic and foods and beverages industry. This study implemented the uses of the G\*Power 3.1.9.2 software and the minimum sample size determined by this software was 31 respondents. The researchers used the non-probability sampling technique which is convenience sampling. Getting access to SMEs was a limitation of the research which warranted resorting to the decision of convenience sampling. Data for this study were analyzed using the following steps. Following the recommended two stage analytical procedures by Hair *et al.* (2014). First, Hair *et al.* (2014) suggested that after the research model is formed, researchers must test the outer model which is also known as measurement model. The objective of evaluating the measurement model is to ascertain the measurement items' validity and reliability. Second, the examination of the structural model (hypothesized relationship) also recommended by Hair *et al.* (2014). Hair *et al.* (2014) also recommend testing the significance of the path coefficients and the loadings by a bootstrapping method by using (500 samples).

## DISCUSSION AND ANALYSIS

**Table 1: Demographic Analysis**

| Demographic          |                       | Frequency | Percentage % |
|----------------------|-----------------------|-----------|--------------|
| Size of Your Company | Micro                 | 50        | 83.3         |
|                      | Small                 | 9         | 15           |
|                      | Medium                | 1         | 1.7          |
| Number of Employees  | Less than 5 employees | 54        | 90           |
|                      | 6 – 75 employees      | 6         | 10           |
| Position             | Senior Manager        | 1         | 1.7          |
|                      | Export Manager        | 3         | 5            |
|                      | Executive             | 56        | 93.3         |

|   |                       |    |      |
|---|-----------------------|----|------|
| Education Level   | Bachelor Degree       | 55 | 91.7 |
|   | Master Degree         | 5  | 5    |
| Engage with internationalization?                                     | Yes                   | 60 | 100  |
|   | No                    | 0  | 0    |
|   | Below 5 countries     | 52 | 86.7 |
| How many countries your company engaged with in internationalization? | More than 6 countries | 8  | 13.3 |

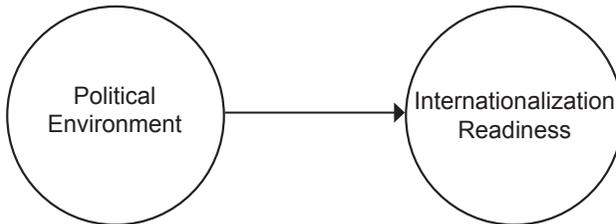
As in Table 1 above, there were 50 SMEs categorized in micro companies. 54 SMEs indicated that they have less than five employees in the company. Other than that, most of respondents involved in this study were from the executive level which is 56 respondents. Most of the respondents possess a bachelor degree which is 55 and the rest are master’s degree holders. 100 percent of the respondents indicated that their company involved in internationalization ranging from various activities such as export activities, subsidiaries, joint ventures etc. These SMEs had engaged with 1-5 countries as 52 respondents agreed with it.

**Table 2: Measurement Model Analysis**

| Constructs | Items | Loadings | Cronbach’s Alpha (CA) | Composite Reliability (CR) | Average Variance Extracted (AVE) |
|------------|-------|----------|-----------------------|----------------------------|----------------------------------|
| IR         | IR1   | 0.842    | 0.891                 | 0.918                      | 0.655                            |
|            | IR2   | 0.770    |                       |                            |                                  |
|            | IR3   | 0.554    |                       |                            |                                  |
|            | IR4   | 0.903    |                       |                            |                                  |
|            | IR5   | 0.877    |                       |                            |                                  |
|            | IR6   | 0.859    |                       |                            |                                  |
| PR         | PE1   | 0.911    | 0.889                 | 0.931                      | 0.819                            |
|            | PE2   | 0.881    |                       |                            |                                  |
|            | PE3   | 0.922    |                       |                            |                                  |

|                                |     |       |       |       |       |
|--------------------------------|-----|-------|-------|-------|-------|
| NC                             | NC1 | 0.864 | 0.906 | 0.934 | 0.780 |
|                                | NC2 | 0.926 |       |       |       |
|                                | NC3 | 0.871 |       |       |       |
|                                | NC4 | 0.871 |       |       |       |
| Constructs                     |     |       | 1     | 2     | 3     |
| Internationalization Readiness |     |       | 0.809 |       |       |
| Political Environment          |     |       | 0.760 | 0.883 |       |
| National Culture               |     |       | 0.748 | 0.800 | 0.905 |

Table 2 shows that all constructs had the values of standardized loadings larger than 0.50 indicating that they met the acceptable standard of factor loadings analysis (Hair *et al.*, 2014). Based on Table 2 the composite reliability for all constructs are above 0.80, indicating that the measurement scale used in this study had a high internal consistency (Hair *et al.*, 2014). The value of the average variance extracted (AVE) is larger than 0.50 indicating that they met acceptable standard of convergent validity (Hair *et al.*, 2014). Table 2 also shows the results of the Fornell- Larcker Criterion analysis. All constructs had a value of larger than 0.5 and every bold value are above than each of the constructs and this indicates that they met the acceptable standard Fornell-Larcker Criterion value (Fornell & Larcker, 1981; Hair *et al.*, 2014).



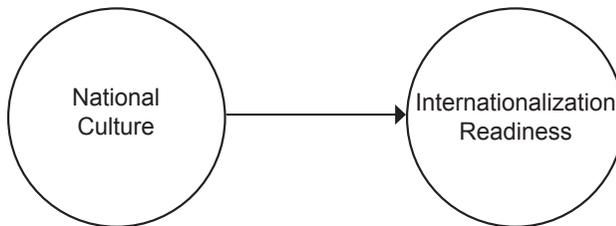
**Figure 2: Relationship between Political Environment to Internationalization Readiness**

**H1:** There is a positive relationship between the Political Environment and Internationalization Readiness.

**Table 3: Structural Model Result (Political Environment)**

| Std. Beta | t-value | Decision  | f <sup>2</sup> | R <sup>2</sup> |
|-----------|---------|-----------|----------------|----------------|
| 0.388     | 2.600** | Supported | 0.148          | 0.632          |

Table 3 also shows that the inclusion of the Political Environment construct had contributed 63 percent in the variance of Internationalization Readiness. In terms of the explanatory power of this model, it provides a substantial support for the overall model (Hair *et al.*, 2014). Later, Political Environment was significantly correlated with Internationalization Readiness ( $\beta=0.388$ ;  $t=2.600$ ), therefore H1 was supported. This has met the acceptable standards of the t-statistics analysis (Hair *et al.*, 2014). In sum, this result demonstrates that the Political Environment is an important determinant of Internationalization Readiness. This finding aligns with Senik, Isa & Ayob (2014) which also found the Political Environment to be significantly correlated with Internationalization Readiness. Other than that, the value of the effect size (f<sup>2</sup>) for Political Environment was 0.148, signifying that the effect size of Rewards was small in the hypothesized model (Hair *et al.*, 2014).



**Figure 3: Relationship between National Culture to Internationalization Readiness**

**H2:** There is a positive relationship between National Culture and Internationalization Readiness.

**Table 4: Structural Model Result (National Culture)**

| Std. Beta | t-value | Decision  | f <sup>2</sup> | R <sup>2</sup> |
|-----------|---------|-----------|----------------|----------------|
| 0.450     | 2.596** | Supported | 0.198          | 0.632          |

Table 4 also shows that the inclusion of the National Culture construct had contributed 63 percent in the variance for Internationalization Readiness. In terms of the explanatory power of this model, it provides a substantial support for the overall model (Hair *et al.*, 2014). Later, National Culture was significantly correlated with Internationalization Readiness ( $\beta=0.450$ ;  $t=2.596$ ), therefore H1 is supported. This has met the acceptable standards of the t-statistics analysis (Hair *et al.*, 2014). This finding aligns with Tihanyi (2005) which also found National Culture to be significantly correlated with Internationalization Readiness. Other than that, the value of effect size ( $f^2$ ) for National Culture was 0.198, signifying that the effect size of Rewards was medium in the hypothesized model (Hair *et al.*, 2014).

## CONCLUSION

Internationalization is crucial as Malaysia with a population of merely 31 million cannot afford to rely on the domestic market to achieve a high-income nation status by 2050. Malaysian SMEs contribute to 19% export, 57% employment and 32.5% GDP. Readiness for internationalization is critical as the fiscal assistance has geared efforts towards accelerating the contribution of SMEs. Generally, SMEs agree that these variables (Political Environment and National Culture) are negative dimensions. However, these variables are important factors because every company should be aware of practices and regulations as these are also known as barriers to penetrate a company. Hence, SMEs should cater for the issues and problems faced by the host country. Based on the result and discussion of this study, the researchers found that the factors that influence and contribute towards readiness for internationalization among SMEs. There is a significant relationship between the political environment and national Culture and Internationalization Readiness among SME employees.

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