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Evaluation of domestic partner relationships and environmental uncertainty on degree of localization and performance of enterprises: The case of Iranian small and medium enterprises

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With the development of organizations and their expansion, and connection to free business global market, the role of small and medium enterprises (SMEs) will appear in space of global competition day to day. Now, these organizations must increase the power of self competition with appropriate visions to gain the ability of competition in the world competitive markets. This research studies the impact of both domestic partner relationships and environmental uncertainty on Iran SMEs' localization strategy and assesses whether this strategy influences the performance of firms. Results showed that environmental stability and domestic network partnerships influence the degree of localization positively and this in turn influences the firm's internationalization performance. The research findings can help SMEs' managers, in that the effective use of localization strategies and also can help them to gain competitive advantage and achieve superior performance.

Key words: Internationalization, performance, growth, small and medium enterprises, Iran.

INTRODUCTION

Nowadays, business environment is challenging and competitive, and organizations require significant resources to face the challenges that surround the environment. Organizations are currently facing unprecedented challenges in an ever dynamic, constantly changing and complex environment (Rezgui, 2007). Therefore, organizations are increasingly facing their own limitations in today's complex and demanding environment (Das and Teng, 2002; Duysters and de Man, 2003; Eisenhardt and Schoonhoven, 1996).

The need for cooperation is evident in an environment characterized by uncertainty, complexity and rapid technological progress (Acs et al., 1996). In this area, the economic weights of industrialized countries were formed

by the SMEs which were determined according to their economies (Korkut et al., 2010). Small and medium sized enterprises (SMEs) are considered to be at the heart of the economic and social life all over the world since they can adapt to demand diversifications easily by creating more product variety with less investment, because they contribute to the interregional balanced development and employment significantly, are complementary of big sized enterprises as supplier industry, and are affected by economic fluctuations (Kaygin et al., 2008). SMEs are believed to provide vital energy and stimulate growth (Heilbroner, 1984; Schumpeter, 1934). SMEs have played an active role in economic growth. SMEs, as an engine of growth, play a particularly important role in developing countries. SMEs are a major part of the industrial economies (Eikebrokk and Olsen, 2007; Robles-Estrada and Gomez-Suarez, 2007). SMEs in USA, Japan and European Union states are regarded as

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important tools in increasing economic development (Oktay and Güney, 2002). Also, Iran revealed that SMEs are so important for economics and development (Ebrahim et al., 2009; Ghaderi, et al., 2010). SMEs' participation in international trade and outward investment is also very significant, for SMEs, such interorganizational links are of utmost importance.

SME networks may facilitate participants' innovation, thus helping them stand out and outperform their competitors (Wincent et al., 2010). It is urgent for SMEs to construct a network service platform to speed up the research and development process (Lan et al., 2004). In the internationalization of firms, small and medium sized enterprises (SMEs) have been the most important players with many SMEs tending to internationalize by utilizing their existing domestic network relationships (Chaney et al., 2004; Johansson and Mattson, 1991). By internationalizing through existing network relationships, the firms tend to take a less incremental internationalization route because they can access knowledge of the market and new processes from the other network members and hence internationalization and growth is accelerated (Bell, 1995; Forsgren, 2001). Their survival depended on their capability to market response, meeting performance and producing goods that could meet international standards (Gomez and Simpson, 2007). According to the preceding discussion, the research objective of this study is to investigate how the network relationships and industrial environmental shape the firm's localization strategy and, in turn, how this strategy influences internationalization performance.

LITERATURE REVIEW AND HYPOTHESES

Small and medium enterprises (SMEs)

There are some definitions of SMEs among countries. Some definitions on SMEs have been stated in quantitative terms, and other definitions have been indicated in qualitative terms. Some researchers express that the definitions must include both the quantitative dimension such as: the number of employees, measure of transactions, financial, non-financial resources and liquidity, and the qualitative dimensions, such as: the method of organizing and function performance (McGregor and Vrazalic, 2004). We think the last term is more reasonable for definition of SMEs. The classification system of North American industries indicated the small and medium enterprises. The firms with less than \$50 million capital are medium, while less than \$10 million are small firms. The numbers of personnel with 250 are medium and lower than 50 are small size firms (Fathian et al., 2008). Based on Europe Union countries, firms with lower than 50 are small and with lower than 250 are mediums enterprises (Kucuk, 2005). In Iran also, different definitions of SMEs have been given. In the definition of

small industries organization, small size production units are those industries that (Khaki, 1993): (I) their investments in a production unit are up to 7,500 million Rials; (II) they have lower than 50 employees; (III) they do not have artistic approach; (IV) they are mechanized; (V) their capital is fully Iranian. Based on the Ministry of Industries and Mines, industries with 10 to 50 employees are called small industries and industries between 50 and 150 employees are called medium size enterprises (Arshadi, 2006). With attention to those definitions, it is revealed that all of countries have some common criteria for classification, such as number of personnel, capital of firm. In this research we focus on these items.

Competitive environment of SMEs

For having a viewpoint on accepting and adopting new and high technology, the agreement of the higher-ranking management in directing employees' effort, education procurement, consultation by information staff and organizational support are necessary (Delone and Mclean, 1992). Organizational support might be related to the innovative character of the company. Consequently, the innovative character of an enterprise is described as the degree of support given to adopt the new technology in that company (Abbasi et al., 2010). Enterprises with more innovative personalities show greater trends to support the use of information technology (Oh et al., 2008). Companies that anticipate innovation could be satisfied with the new technology services. In other words, if companies are conservative, they withdraw from accepting new technology. In addition, if the innovative companies perceive usefulness and ease of use in e-commerce, they will adopt it easily (Abbasi et al., 2010). In this decade, competition increases the probability of adopting technology. Many studies revealed that competitive pressure affects a company's decision on adopting information technology (Abbasi et al., 2010; Iacovou et al., 1995; Sarlak et al., 2009; Yu and Tao, 2009). The firm would not undertake internationalization activities if their perceived risk was higher than the tolerable level (Forsgren, 2001; Sorooshian et al., 2011). Prior studies have pointed out that inter-firm networks could be an important approach to help firms in reducing the perceived uncertainties and risks of internationalization (Kirby and Kaiser, 2003; Wu and Huang, 2002). Lambe and Spekman (1997) further argue that an uncertain market environment usually encourages foreign firms to form network partnerships in the market. Information technology maturity is one of the important variables in the adoption of new technologies. To estimate information technology, maturity of companies demands a consideration of both hardware and software prerequisites.

Majority of Iranian firms agreed that "intense competition in the industry," is the main factor causing

earnings to decline and it is suggested that the development of networks may be a method to counteract a competitive environment. The networks are likely to be even more important in the international environment as knowledge of the environment local can be shared and adaptations to strategy be made to the advantage of all partners. The network relationships of a firm can function as a bridge to other local networks with the international firm using these relationships to get into the networks in foreign countries (Johansson and Elg, 2002). However, existing network relationships can be used by firms to accelerate the internationalization process and facilitate international growth, these same networks may also inhibit the international market development of the firms (Bell, 1995; Coviello and Munro, 1997). Due to the high interdependence of the network partners and high integration of production processes, the firms usually have more difficulty in forming partnerships with local firms (Karagozoglu and Lindell, 1998). By focusing on the network relationships, we developed the first hypothesis:

H₁: The organization's localization in a foreign country was affected by interdependence of network with domestic partners.

Localization of SMEs in overseas markets

Focusing on needs of the international environment is one of important matter to firms embarking on internationalization; the company's global production and distribution is full of many uncertainties and risks, due to customs, laws and politics of different regional markets. Therefore, firms must often adopt different strategies for different markets. Therefore, finding a solution to solve this issue is very important. Organizations in their effort to survive and overcome resource scarcities SMEs are increasingly looking for competent partners that provide them with complementary assets and resources (Almeida and Kogut, 1997; Hite and Hesterly, 2001; McEvily and Zaheer, 1999; Narula, 2004). However, the complex environment, the limited resources, and scanning abilities, make it difficult for SMEs to find competent partners. It is better for a firm when operating in host markets, to launch undertake a "production first, marketing later" strategy focus on the production in the host country in the initial phase, and explore new marketing channels in later stages. This strategy also allows the firms to start their internationalization at a low cost, as they usually start their production in host countries by bringing their existing production equipment and technologies (Gereffi and Pan, 1994).

Chung (1997) stated that long-term relationships and mutual trust with their original suppliers, many firms tend to continue these business relationships when they internationalize to other markets. This issue might be caused by the firms' weak ability to internationally source

material inputs and machinery. Also, this is not a significant problem, because the firms may obtain lower prices when they continue sourcing from home firm, as original suppliers try to keep their customers by offering competitive prices or additional logistic services (Chou and Lin, 1999). It is a strategic matter when firms establish overseas manufacturing centers, they must decide whether to import raw materials and components from the parent country or use local materials. Also it is important that SMEs cannot challenge in the market, unless they do their need customer, and have to reduce time and cost for productions (Mohammadjafari et al., 2010). Localization of the supply chain can bring many advantages, including lower prices for raw materials and transportation, shorter delivery times, and the establishment of partnerships with local firms (Zhang and Goffin, 1999). If the supply of raw materials is from overseas, it may increase both the transport and warehousing costs, and, due to distance may put at risk timely supply (Levy, 1995). The best method of Iranian companies setting up their own factories overseas is to establish a competitive manufacturing base both in terms of price and quality. From a global point of view, moving Iranian's industrial production base to those overseas markets that provide lower production costs does incur some degree of localization.

Based on the preceding discussion, overseas market environment can play an important role in the firms' localization conditions; we developed the second hypothesis:

H₂: Decreasing risk in the international environment has a positive effect on the organization's localization in the overseas market.

Internationalization performance of SMEs

Certainly, internationalization is positively related to SMEs growth (Delios and Beamish, 1999a; Geringer et al., 1989; Hitt et al., 1994; Hitt et al., 2006; Kim et al., 1993; Kogut, 1985; Luo et al., 2005; Qian and Li, 2003; Tallman and Li, 1996). By broadening customer bases by way of entering other countries, firms can achieve a larger volume of production and growth leading to economies of scale (Lu and Beamish, 2001).

Extant of literature on the SMEs internationalization have focused much in North America and Europe (Coveilo and Munro, 1997; Gemser et al., 2004; Moen and Servais, 2002; Pangarkar, 2008). Only in the last half decade, there have been growing interest among both academics and researchers who have turned their attention to internationalization of SMEs in emerging economies, such as China (Ahlstrom et al., 2008), India (Saini and Budhwar, 2008), Malaysia (Shankar et al., 2010), Taiwan and Singapore (Sim and Pandian, 2003) and Vietnam (Thai and Chong, 2008). Bourcieu (2005) and Etrillard (2005) shows that internationalization

follows a strategic operation of specialization; SMEs are then seeking to find new markets on the basis of their current products (Bello, 2009). In the internationalization performance literature, previous studies tended to focus on SMEs' exporting activities and their exporting performances (Shoham, 1998). The performance of the SMEs in other internationalization activities (for example, FDI), however, has received less attention. Obtaining detailed information on SMEs' foreign investments and their financial data may be the stumbling block (Lu and Beamish, 2001; Wolff and Pett, 2006). Furthermore, most of the previous studies of internationalization performance have tended to focus on the firm's profitability and other financial performance (Lu and Manitoba, 2002). However, business success of SMEs is not merely related to their financial performance (Kotey and Meredith, 1997).

Indeed, accounting measures are usually less reliable in SMEs than in larger firms (Majocchi and Zucchella, 2003) and thus in any study of SMEs other non-financial performance indicators are also worth considering. Delios and Beamish (2001) argued that a firm's performance is a multi-dimensional construct and should be measured using a number of variables. The relationship between internationalization and performance is a challenging matter, because the scope of the related investigations covers diverse industries, time periods, and motivations (Geringer et al., 2000). Employing both financial and non-financial measures is most appropriate in the SME context where financial data is often unavailable or incomplete (Bergeron et al., 2004). This study, therefore, intends to examine the firm's performance in both financial and non-financial terms. We can suppose that the foreign direct investments in SMEs industries are tending to follow a localization strategy. Therefore, it is suggested that those Iranian firms that have a higher degree of localization will in turn have higher performance. Accordingly, we establish the third hypothesis:

H₃: Internationalization performance is positively affected by localization of organizations.

RESEARCH METHODS

Data collection and measures

This research investigated the study by surveying internationalized Iranian firms in the business sectors. According to the literature and hypotheses, the variables measured in this research include network relationship, competitive environment, localization, and internationalization performance. Network relationship included transaction relationship lock-in effect (Gulati et al., 2000; Wolff and Pett, 2006; Makino et al., 2002). Competitive environment included industrial competition degree and industrial internationalization degree. Localization included production localization and management operation localization. Finally, internationalization performance included non-financial performance (Brouthers et al., 2000; Lin et al., 2007), and financial performance (Brouthers, 2002;

Chen, 1999; Hsu and Pereira, 2008; Taggart, 1999).

A number of organizations from the business industry in Iran have been chosen as the subjects of the study through purposive sampling. With the consent of the subjects on a questionnaire survey, we enlisted the help of the firms to each designate a window for questionnaire distribution and collection. Participants were approached in their respective organizations. After having established rapport with the participants, they were asked to respond to each statement in the questionnaire about the way they feel, think or act in their lives or organizations by encircling the number that most appropriately matched their answer. They were requested to fill the questionnaire on the spot or on their convenience and return it to the researchers. A total of 650 copies of the questionnaire were delivered to organizations and in the following two weeks, 193 copies had been returned with 180 valid samples. Participants indicate level of agreement on a 5-point Likert scale (1 = strongly disagree, 5 = strongly Agree). Cronbach's alpha revealed that overall reliability of these variables is approximately 86.4%. Therefore, this research has a significant reliability. The obtained data were initially subjected to exploratory factor analysis (EFA) to extract factors identified as network relationship, competitive environment, localization and internationalization performance. The hypotheses were then examined through regression analysis.

RESULTS AND FINDINGS

Exploratory factor analysis was used, resulting in the four factors of network relationship, competitive environment, localization, and internationalization performance. Using principal components analysis (PCA) as the factor extraction method, the Varimax as orthogonal rotation method, and eigen-value greater than 1 helped identify the latent dimensions of the constructs. The Kaiser-Meyer-Olkin (KMO) measure of sampling adequacy (0.62) and Bartlett's test of sphericity ($P = 0.000$) indicated that results were suitable for EFA. In the extraction of the items, we excluded the various components in the factor loading of items that were less than 0.6. The EFA extracted network relationship using two measures "transaction relationship lock-in effect" and "resource dependence with Iran", and these explained 66.9% of the total variance. Competitive environment was comprised of "degree of industrial competition" and "degree of industrial internationalization", and explained 68.6% of the total variance. Localization was extracted from "production localization" and "management operation localization", and explained 62.8% of the total variance. Internationalization performance was extracted from "non-financial performance" and "financial performance", explaining 72.7% of the total variance. Furthermore, most factors showed that the Cronbach's α values were greater than 0.7, thus indicating adequate internal consistency.

This study used regression analysis to explore the relationship between variables. Initially, Pearson correlation analysis was employed to understand the linkages between the various dimensions. The correlation analysis results revealed that the various dimensions of this study were positively correlated (Table 1), with

Table 1. Pearson correlation matrix of variables.

Variables	Mean (S.D.)	Network relationship	Competitive environment	Localization	Internationalization performance
Network relationship	4.33 (0.37)	1.000			
Competitive environment	4.89 (0.40)	0.56**	1.000		
Localization	4.74 (0.47)	0.42	0.51**	1.000	
Internationalization performance	4.37 (0.52)	0.43	0.39	0.46*	1.000

*p < 0.05 ; **p < 0.01.

Table 2. Regression models of research.

Parameter	Model 1	Model 2	Model 3
	Dependent variables: Localization	Dependent variables: Localization	Dependent variables: Internationalization performance
Independent variables	Coefficient	Coefficient	Coefficient
Network relationship	0.27*		
Competitive environment		0.49***	
Localization			0.38**
Constant	4.3	3.1	3.3
Adjusted R^2	0.32	0.44	0.41

*p < 0.05, **p < 0.01, ***p < 0.001.

several being significant: network relationship and competitive environment; localization and competitive environment; localization and internationalization performance.

The regression analysis explored the impact of the network relationship and competitive environment on the localization, and the impact of localization on the internationalization performance.

Three regression models were established. Model 1 is a regression model for network relationship affecting localization. Model 2 is a regression model in which competitive environment affects localization. Model 3 is a regression model in which localization affects internationalization performance. Adjusted R^2 for the three regression models ranged are 0.32, 0.44 and 0.41, respectively, F value is significant ($p < 0.01$). Therefore, all three regression models have explanatory power (Table 2).

From the preceding analysis of the results of the three regression models (Table 2), it is evident that the impact of network relationship on localization is not significant ($\beta = 0.27$; $p > 0.05$), the impact of the competitive environment on localization is significantly positive ($\beta = 0.49$; $p < 0.001$) and the impact of localization on internationalization performance is significantly positive ($\beta = 0.38$; $p < 0.01$). In addition, H1, H2 and H3 were supported.

DISCUSSION

Recently, small and medium size enterprises have been receiving increased attention as the subjects of research. Iranian firms engage in internationalization through their existing networks. Networking linkages may affect firms' internationalization (Chen and Chen, 1998; Johanson and Mattson, 1988; Kirkels and Duysters, 2010). These results suggest that the dependency on technology and resources from the parent company in Iran would not be a barrier to localizing operations. As to the practical contributions, the network relationships play a very important role in internationalizations of multinational corporations (MNCs) from emerging economy. As compared to MNCs based in developed countries, MNCs from emerging economies tend to be smaller in size and possess limited resources and advantages, and often more dependent on network linkages because of the risks and managerial complexity associated with FDI. Network relationships between customers and suppliers or between producers and distributors typically play important roles in their activities in host countries, either in sales or production (Bradley et al., 2006; Fujita, 1995; Freel and Robson, 2004). Chen (2003) indicated that in the development stages of internationalization, MNCs would initially build relationships within the host country and then seek to expand the new network.

Sasi and Arenius (2008) agreed that firms might

consider expanding their overseas venture for increased profit and growth by developing the network configuration from a dyadic relationship to a multilateral network with tentacles both in the home and foreign locations. This is evident in the decreasing raw material procurement ratio from the home country and host countries of Iranian firms. Accessing local suppliers through the development of local networks can lead to more timely inputs to the production process and more positive relations with the local market. This phenomenon is consistent with the views of the network configuration shift (Sasi and Arenius, 2008). Also the results show that instability in the competitive environment in the host market positively influences the firm's degree of localization. For example, when there is a high level of competition, Iranian firms increase their localization activities to counteract the competition. Employing local resources and production processes may be less costly than using resources from Iran affording the firms that localize the ability to compete more strongly on price.

Localizing is perceived as one major method of competing in overseas markets. The finding shows that the network relationship and the business environment can impact on the level of localization of Iranian firms, however the question remains as to whether localizing your operations will improve performance. More specifically, this study hypothesized that a high degree of localization can contribute to increase performance, in both financial and non-financial terms. Results of the regression support the hypothesis that a firm's localization degree would positively influence the internationalization performance. Two possible reasons can explain the link between localization and performance. Firstly, increased performance may result from the "informational benefits" offered by the local partners, as this enables the firms to acquire essential market knowledge as well as connect with the local market. Secondly, the localization-performance link can also be a consequence of the superior performance of the local network in the host market creating more unsolicited demand for the partners. Internationalization provides opportunities for firms to grow and is beneficial for firms to integrate resources. As the globalization trend has increased, relationships between manufacturers and suppliers have become more complex.

By internationalizing within the home region, small and medium enterprises (SMEs) can better acquire critical information about local business practices and consumer preferences. SMEs learn more efficiently because the country is culturally related and nearby in proximity (Ruigrok and Wagner, 2003). Previous studies pointed out that firms usually have more difficulties in localizing, by forming partnerships with local firms due to the high interdependence of their original network partners and high integration of the production process (Karagozoglu and Lindell, 1998; Aksu et al., 2011). Thus, to conquer an overseas market, the enterprise must meet some

environmental requirements.

SUGGESTION, LIMITATION AND FUTURE RESEARCH

In the international scenario like the current deep economic and financial crisis, what pushes SMEs to seek the ways and means enabling them to ensure their survival; offering the customers products adapted to their needs at competitive prices? What supposes efforts of improvement of the quality of products, efforts of adaptation of products to the customers' requirements, efforts of modernization of production equipments, efforts of using qualified people for the achievement of specific tasks, efforts to improve equipments of cost prices and efforts to use distribution networks adapted to the environment requirements? Moreover, it is important to note that the environmental questions represent today a major strategic issue for the competitiveness of enterprises. For that purpose, the SMEs need financial, material, technological and human resources, but also specific competences.

To achieve this goal, the role of government is vital. If the SMEs of a country can gain a further market of global market, the rate of economic growth will increase. For showing the importance of SMEs for a country, we can simulate the SMEs to person's organs that brain is the leader of them. When the organs can work accurately that the order from brain was correct. Therefore, the leaders of a country must have a specific attention to SMEs, and can do an extra financial support.

This research does have certain limitations. For instance, because different measurements have different implications, they should have their own antecedent and consequence variables. It is important to recognize limits to generalizability, as our study was based on the business sectors only, and different industries may have different internationalization track on their performance implication (Chiao et al., 2006); thus, its applications to other industries should be made with caution. Although the response rate is acceptable statistically, the research findings could have been more constructive if more responses had been received. The research suggests that future research focus on the high profits and other positive effects (for example transportation, investment performance, merger and acquisition, etc). Also, it will be suggested for future researches that study broader investigation of different industries, like service industries, electrical industry, etc.

Conclusion

In this decade, it is obvious that the role of SMEs has further increased, hence the need to keep them technologically competitive. In the emerging global information economy, it is the smaller firms that could be the most significant winners. This, however, is to a great

extent dependent on the quality and competitiveness of their products in the international market. E-business offers SMEs exceptional possibilities to compete on global markets and to weave strategic and networking alliances with other players around the world.

This study investigates how network relationships and environmental factors shape the internationalized firm's localization strategy. Previous research has tended to focus on the motivations to internationalize, choice of entry modes and internationalization performance with less emphasis on the internationalization strategies after entering overseas markets. This study attempts to fill in the gap regarding the factors that might lead to localization and indeed whether localization is associated with better performance. Furthermore, the study surveyed Iranian manufacturers operating in overseas markets exploring the impact of their existing network relationships to its localization strategy and internationalization performance. Traditionally, the collective relocation of the corporate network by Iranian enterprises is an important feature of transnational investment. However, the benefits of networking with local firms such as shortening delivery time, responding quicker to market changes and demand and reducing production costs, have changed the strategy of many Iranian firms to one of localization.

Industry clusters in Iran have been considered a source of industrial competitiveness and thus the strategy of network relationships is often extended to the international environment with Iranian firms following an approach of herd internationalization entering overseas markets with their existing network. This may help firms in the initial period of internationalization as it can reduce the initial risk and cost of entering overseas markets. However, for long-term sustainability it may be more beneficial to break out of these networks and build relationships with local suppliers and customers.

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