



What drives the export performance of small and medium-sized subcontracting firms? A study of Korean manufacturers



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ABSTRACT

Building on the resource-based view and network theory, we propose and test a framework of export antecedents of subcontracting small and medium-sized enterprises (SMEs). Whereas the internationalization of firms has been extensively studied in general, little is known about what drives the exports of subcontracting SMEs which play a very important role in the manufacturing sectors of East Asian economies. These subcontracting firms operate under very different conditions from other companies, resulting in specific ways they leverage their resources, capabilities and customer networks. An analysis of survey data from 1733 subcontracting SMEs in three South Korean manufacturing industries reveals that the firms' export orientation and export intensity are related not only to their technological resources and their executives' managerial capabilities, but also to features of their subcontracting network ties. Our study suggests that due to the specific nature of their business, subcontracting firms' internationalization antecedents need to be analyzed in the context of their business environment which is strongly shaped by their customer relationships.

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1. Introduction

In this study, we examine the highly relevant yet under-researched internationalization of subcontracting small and medium-sized enterprises (SMEs). Generally speaking, the topic of the internationalization of firms has been extensively studied (Fletcher, 2001), but research attention has been uneven for different types of firms. While internationalization research has initially been mostly analyzed with reference to large corporations, small and medium-sized enterprises (SMEs) are playing an important role in the internationalization of markets while strongly contributing to countries' exports (Lu & Beamish, 2001; Oviatt & McDougall, 1999).

However, much of the extant SME internationalization research has focused on specific types of firms. In particular, technology-intensive ventures and 'born globals' have been quite extensively studied in research on international entrepreneurship (e.g., McDougall & Oviatt, 2000; Ruzzier, Hisrich, & Antoncic, 2006). These companies are not necessarily representative for internationalizing SMEs, particularly in the manufacturing sector. Many

manufacturing SMEs pursue internationalization within the context of multi-tier global supply chains through subcontracting transactions in response to customer preferences (Bradley, Meyer, & Gao, 2006). Subcontracting firms are defined as firms which carry out the processing of a material, component, part, or subassembly for it, according to specifications provided by customer firms (Imrie, 1986). They play a very important role in the dynamic and highly internationalized manufacturing sectors of East Asian countries such as China, Japan and South Korea, with approximately half of all SMEs being subcontracting firms (Cho, 2014). However, we know surprisingly little about the driving forces of their internationalization.

Subcontracting relationships are based on customized work for specific customers who have the overall price, quality and delivery responsibility when selling products or services, including subcontracted work, to third parties (Andersen & Christensen, 2005). This relational setup has two important implications for subcontracting SMEs. First, they do not have full control over their production value chains, as input materials, machinery or technical specifications are provided by their customers (Furlan, Grandinetti, & Camuffo, 2009). Due to their incomplete value chains, subcontracting firms therefore face strong challenges when internationalizing their business, even more so than other SMEs which offer their own products or services to customers (Bradley et al., 2006; Wynarczyk & Watson, 2005). Research on SMEs

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indicates that their internal resources and capabilities are important antecedents of their internationalization (Filatotchev, Liu, & Wright, 2009; Knight, 2000; Oviatt & McDougall, 1999; Westhead, Wright, & Ucbasaran, 2001). The resource scarcity which subcontracting SMEs are facing suggests that these resources and capabilities are particularly critical for the internationalization of these firms. However, their relevance for the internationalization of subcontracting SMEs has largely remained unexplored.

Second, the business network relationships between subcontracting firms and their customers exhibit a much higher degree of closeness and interdependence than business ties related to general transactions between independent companies in supply chains. These features of subcontracting firms' customer network ties have various potential implications for their internationalization. On the one hand, subcontracting may lock these firms into captive relationships with a small number of customers they are highly dependent on and inhibit them from developing and selling their own products (Gereffi, Humphrey, & Sturgeon, 2005). Such hierarchical network ties may constitute a barrier to subcontracting firms' internationalization, as these firms suffer from a high resource dependence on their key customers and are therefore severely constrained in their business development (Sacchetti & Sugden, 2003; Sambharya & Banerji, 2006). To illustrate, Kimura (2002) found Japanese subcontracting firms to be less internationalized than their non-subcontracting counterparts. On the other hand, the internationalization of SMEs may also be enhanced by subcontracting when sophisticated customers provide them with valuable technological and market-related knowledge (Hayashi, 2002) in more balanced 'networks of mutual dependence' (Sacchetti & Sugden, 2003). Furthermore, additional internationalization opportunities may be given to subcontracting firms when customers internationalize their operations and invite subcontractors to extend their working relationship to other countries. As these considerations show, the overall influence of subcontracting network ties on the internationalization of SMEs that are engaged in such work is anything from clear-cut.

In this study, we are proposing and testing a framework of export antecedents of subcontracting SMEs which considers the specific nature of these firms' business environment. Previous research on SME internationalization has shown that firms are embedded in networks which enable them to learn (Johanson & Vahlne, 2009) and acquire crucial knowledge for successful international expansion (Andersson & Florén, 2011). However, extant studies on SME internationalization mostly focus on firms which independently enter international markets, and on the role of networks in this process. In contrast, there is little consideration of the specific nature of subcontracting relationships in these studies.

As exports are the predominant internationalization mode for subcontracting SMEs (Andersen, 1999; Bacchiocchi, Florio, & Giunta, 2014), we subsequently focus on their export performance, measured by two dimensions: export orientation (whether a firm exports or not) and export intensity (the ratio of export sales to total sales).

In order to capture the key aspects of resources, capabilities and customer network ties for subcontracting SMEs, we develop a framework of their export performance antecedents based on the resource-based view and network theory. Our framework is tested with recent survey data from subcontracting SMEs in the South Korean (hereafter: Korean) manufacturing sector. Korea is an interesting case for studying the export performance of subcontracting firms, as it is seen as a representative East Asian economy with large, competitive and highly globalized manufacturing industries (Hemmert, 2012), and subcontracting relationships

between large assemblers and small and medium-sized suppliers are widespread (Cho, 2014). Due to the strong business cultures in East Asian countries (Lee, Roehl, & Choe, 2000) as well as relatively strong country-level trade barriers and regulations, subcontracting firms can be expected to face higher hurdles for developing export business in this region than their counterparts from other regions such as Europe. At the same time, the high degree of globalization of the Korean manufacturing sector and the offshoring of production activities by large manufacturers increases the pressure on subcontracting SMEs to engage in exporting for long-term survival. Therefore, it appears particularly important to identify the factors which enable Korean subcontracting SMEs to overcome these hurdles and enhance their export performance.

Taken together, this study aims to contribute to the literature on SME internationalization by (1) applying the resource-based view and network theory to the subcontracting context, (2) theoretically identifying potential key antecedents of internationalization for subcontracting firms, and (3) verifying the empirical relevance of these factors by examining the driving forces of export performance for a large sample of subcontracting SMEs in three Korean manufacturing industries. Subsequently, we develop our research model and hypotheses. Thereafter, we elaborate on our empirical study and report and discuss its results. Finally, we consider limitations of our study, future research directions, and managerial and policy implications.

2. Theory and hypotheses

2.1. Resources, capabilities and subcontracting SMEs' export performance

The resource-based view emphasizes how organizations may achieve sustainable competitive advantage by developing resources and capabilities and has been a central foundation of internationalization theories of firms in developing the concept of firm-specific advantages (Dunning, 1988; Hennart, 1991; Hymer, 1976). The creation of sustainable advantages can be related to firms' control over valuable, rare, non-imitable and non-substitutable resources (Barney, 1991). When compared with large firms, SMEs control fewer resources, however, and this relative lack of resources is widely considered as a critical constraint for their internationalization (Coviello & McAuley, 1999; Lu & Beamish, 2001). Therefore, we focus on resource-related factors when developing a model of the export antecedents of subcontracting SMEs.

Internal capabilities to leverage key resources have been found to be crucial for subcontracting SMEs (Furlan et al., 2009). Subcontracting firms tend to rely strongly on key customer firms and need to make use of resources in their relationships with these customers in order to receive export opportunities (Furlan, Grandinetti, & Camuffo, 2007). In other words, the resources and capabilities of subcontracting firms primarily need to be assessed in the context of customer needs (Oke & Onwuegbuzie, 2013). Whereas the processing of tasks for customers and thereby, the management of material flows and operations may be regarded as core activities of subcontracting firms, these activities alone will often be hardly sufficient to enable such firms exporting. Specifically, we argue that in addition to their core operations, subcontracting firms need to leverage technological resources, marketing resources and financial slack resources, and the managerial capabilities of their executives to address customer needs and thereby receive opportunities for export business. These resources and capabilities enable subcontracting firms to create competitive products or services, offer these products or services proficiently to their customers, have sufficient financial slack to maintain stable operations throughout business cycles and

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