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Barriers and public policies affecting the international expansion of Latin American SMEs: Evidence from Brazil, Colombia, and Peru☆

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ABSTRACT

The paper aims to improve the understanding of the determinants of the international expansion of Latin American SMEs. To do this, it adopts an institution theory perspective to study the interaction between public policies and other drivers of SMEs' expansion in four main areas: access to public financial resources; access to public procurement contracts; adverse regulatory and inconsistent legal frameworks; and public assistance on information and knowledge about markets. We collected the data from 465 SMEs in Brazil, Colombia, and Peru and analysed it using multivariate regressions; the findings have implications for theory, practice, and policy making. The results suggest that Latin American SMEs belonging to larger institutions (like business groups) seem to be in a stronger position to expand internationally. In addition, they show that SMEs perceive difficulties/barriers for their international expansion, mainly in dealing with domestic regulations in the domestic economic environment, and in poor information about external markets. Also, the findings indicate that having the government as a customer has proved to be a facilitator for the firms to expand internationally. All in all, the findings of the paper enrich the debate on the impact of institutions, and in particular of public policies, on the international expansion of SMEs from emerging and transition economies by analysing the role of governments' policies and strategies intended to support the international expansion of firms and questioning their mid- to long-term impact.

1. Introduction

How do managers and owners of small and medium-sized enterprises (SMEs) perceive barriers for their international expansion strategic decisions? Do constraints such as restricted access to financing and inefficient government assistance programs hinder the international expansion of Latin American SMEs? Do adverse domestic macroeconomic environments, weak legal frameworks, and cumbersome regulatory systems pose difficulties for SMEs' international expansion? How does the role of public procurement contracts affect their decision making process regarding their expansion strategies? How do public policies affect SMEs' internationalisation strategies? Answering these questions is relevant as SMEs are a fundamental building-block of the productive structure of the region "accounting for around 99% of business and employing around 67% of employees" (OECD, 2012) as well as a key agent of a much needed structural change in Latin American economies (ECLAC, 2013).

Nevertheless, most of the research on emerging market firms, in particular, Latin American firms has focused almost exclusively on multinational corporations (MNCs) (Dominguez & Brenes, 1997; Contractor, Kumar, & Kundu, 2007; Luo & Tung, 2007; Lopez, Kundu, & Ciravegna, 2009; Nicholls-Nixon, Castilla, Garcia, & Pesquera, 2011; Vassolo, De Castro, & Gomez-Mejia, 2011; Ciravegna, Lopez, and Kundu, 2013; Ciravegna, Fitzgerald, and Kundu, 2013) and the few works on Latin American SMEs are narrow in focus and cover only a scattered range of areas. These works have studied the development, growth, and mortality of SMEs in a few countries in the region (Carroll & Delacroix, 1982; Swaminathan, 1996), the relations between the context and the entrepreneurial activity (Dana, 1988; Dana, 1997), the factors limiting the activity of small firms in countries like Honduras, Ecuador, and Mexico (Busch, 1989; West, Bamford, & Marsden, 2008; Young & Welsch, 1993; Yu-Way & Zuniga, 1987), or the development of export-related competitive advantages in Argentina, Chile, and Colombia (Milesi, Moori, Robert, & Yoguel, 2007). In addition, little has been published on the impact of governments' programs for SMEs across the region

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(Lopez Acevedo & Tan, 2010). This has resulted in a fragmented body of knowledge and as such a major gap in the academic literature.

This limited knowledge about Latin American SMEs and their specific needs along with a poor availability of financial and human resources in the region (Hoskisson, Eden, Lau, & Wright, 2000) have resulted in poorly designed public policies, weak regulatory frameworks, and low development of firm-level capabilities to overcome the barriers to their expansion (West et al., 2008; Zevallos, 2003). In fact, the region's firms present relatively low levels of productivity in microenterprises (thirty-three times lower than that in large companies in the region, compared with only 2.4 times lower than that observed in OECD countries) and in small firms (six times lower than that in large companies, compared with 1.6 times lower in OECD countries), and also in relatively low levels of internationalisation with only 10% of Latin American SMEs engaging in export activities (compared with 40% of their European counterparts) (ECLAC, 2013). Also, the region's SMEs are having difficulties in participating in and benefitting from global value chains (ECLAC, 2013) and are also suffering from an increased international competition in their home markets mainly from Chinese firms (Fornes & Butt Philip, 2014; Jenkins & Barbosa, 2012). In this context, understanding the public policies, institutional settings, and business capabilities needed to overcome barriers is critical for the SMEs' development.

The present study aims at filling this gap. The premise is that, similar to what was found in small business in other emerging and transition economies, in particular China (Cardoza, Fornes, Li, Xu, & Song, 2015), SMEs in Latin America that benefit from sound government policy frameworks, favorable environmental conditions, and well-designed assistance programs are more likely to expand internationally (Zevallos, 2003). To this end, the study uses a systematically collected firm-level data-set and adopts an institution theory perspective to study the interaction between public policies and other drivers of SMEs' international expansion.

Summing up, a thorough understanding of the impact of barriers and policies on Latin American SMEs' international expansion is needed to extend the international business literature in emerging countries. In this sense this article intends to contribute to this body of literature in several ways: (i) by studying the relation between public financing, public procurement, regulatory frameworks, assistance programs and the international expansion of SMEs from developing countries, (ii) by providing a unique setting to test the set of barriers reviewed by Leonidou (2004) on the internationalisation of SMEs from industrialised countries, and (iii) by contributing to the development of a conceptual framework for the international expansion of Latin American SMEs. The study also expects to draw important lessons from the Latin American experience that can offer useful insights for policy-making in transition and emerging economies interested in accelerating the expansion process of their SMEs and benefiting from globalisation.

The paper is organised as follows. The next part presents the conceptual framework, provides a general overview of the main scholarly contributions to theory, and introduces the hypotheses. Section 3 explains the sample, methodology, and research design. The paper concludes with a discussion of the results, their implications, and possible directions for future research.

2. Review of the literature and hypothesis development

Institutional theory presents a relevant theoretical framework to understand the behavior of firms when markets are still in formation (Hoskisson et al., 2000) and as such it has been used to analyse the behavior of firms in emerging markets. This is because several factors are considered to affect their institutional environment, defined as "the set of fundamental political, social and legal ground rules that establishes the basis for production, exchange and distribution" (Davis & North, 1971); among them cultural diversity (Hofstede, 1981; Kogut & Singh, 1988), unfamiliarity with business conditions (or liability of foreignness) (Johanson & Vahlne, 1977; Zaheer, 1995), and public policies, legal institutions, and regulatory structures (Davis & North, 1971; Peng & Heath, 1996; Peng, Wang, & Jiang, 2008; Yeung, 2002).

For example, following this stream, Peng and Heath (1996) analysed how different public policies and institutional environments determine the growth strategy of state-owned enterprises in transition economies. Similarly, Zhu, Wittmann, and Peng (2011) identified several institution-based barriers to innovation and business growth in China; in particular, barriers related to access to financing, the quality of laws and regulations, and the effectiveness of support systems, besides competition fairness and tax burdens. Also, Child and Lu (1996) found that firms from emerging and transition markets face different institutional constraints related to intervention by authorities and regulatory bodies in the decision making process, restrictions of information usually controlled by authorities, and access to public funding. Likewise, weak institutional frameworks, characterised by shortages of skilled labour, deficient capital markets (Hoskisson et al., 2000) and low levels of legitimacy (Yamakawa, Peng, & Deeds, 2008) were observed to affect companies' strategies and performance.

In this context, studies on Latin American emerging economies have also shown that the region's institutional environment is a key mediator in most firms' management issues (Nicholls-Nixon et al., 2011) as it is vulnerable, presents institutional voids, and "a weak market infrastructure" that favors "high levels of corruption and informal business activities" (Vassolo et al., 2011). Institutional voids (translated mainly into higher transaction costs and market failures evident in the region's relatively poorly developed capital and labour markets) have led to the development of business groups (legally independent companies bound together by formal and/or informal arrangements organised to take coordinated actions in their strategic pursuits and perform some of the missing market functions themselves (Carrera, Mesquita, Perkins, & Vassolo, 2003; Khanna & Palepu, 2000)). Also, weak market infrastructure has encouraged the growth of informal firms that commercialise legal products but manufactured and sold without paying taxes and/or considering regulations which has resulted in an environment where competition is not necessarily fair (de Soto, 1989) (contradictorily, this informal economy has been found to play a positive role in the region as it is responsible for around 50% of the employment in Latin America (World Bank, 2008) and as such an important source of wealth creation and employment in many countries (Bennett, 2010)). Vulnerable institutions in Latin America have also been found to be responsible for the volatility of the economy that has had a negative effect in the development and growth of the region's companies (Calvo, Izquierdo, & Talvi, 2006; Fornes & Cardoza, 2009; Milesi et al., 2007).

All in all, the relatively weak institutional context, along with a volatile macroeconomic environment in Latin America, seem to have created a non-conducive environment for the development of competitive advantages on which firms could base an international expansion (Chakrabarti, Vidal, & Michell, 2011; Milesi et al., 2007). In addition, institutional voids create a context that offers great opportunities for arbitrage and the growth of informal firms (Vassolo et al., 2011) which may also hinder the incentives to develop competitive enterprises.

2.1. Business development systems: a trigger for SMEs' international expansion?

Latin American SMEs are "highly heterogeneous in terms of access to markets, technologies, and human capital as well as their linkages with other firms; and these factors affect their productivity, export capacity, and potential growth" (OECD, 2012). To overcome these limitations and realise their potential Latin American governments have designed and applied business development systems (BDS) aimed at offering training for workers and managers, upgrading technology, controlling and improving quality and productivity, developing markets and, promoting exports (Lopez Acevedo & Tan, 2010). These BDS are focused on addressing market imperfections (that are supposed to affect SMEs