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Building international business bridges in geographically isolated areas: The role of foreign market focus and outward looking competences in Latin American SMEs

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ABSTRACT

This paper focuses on the internationalization of SMEs located in geographically isolated contexts like Latin America. We argue that strategic priorities towards foreign markets, Foreign Market Focus (FMF), as well as “Outward Looking Competences” (OLC) are important factors in enhancing productivity, and ultimately achieving a sustainable competitive presence abroad. FMF and OLC lay the foundation for setting better international business relations with foreign clients and increase opportunities for learning and attaining economies of scale. Results demonstrate the significance of FMF as a means of enhancing productivity only in manufacturing firms. OLC positively moderates the relation between FMF and productivity.

1. Introduction

There is a burgeoning literature on the internationalization of emerging market multinationals focusing on their internationalization strategies, entry modes, location and performance (Cuervo-Cazurra & Ramamurti, 2014; Gonzalez-Perez & Velez-Ocampo, 2014; Kim & Aguilera, 2015). However, little research has been conducted on how Latin American exporting small and medium enterprises (SMEs) behave in the initial stages of their internationalization process (Perez-Batres, Pisani & Doh, 2010), and the impact thereof on their capacity to learn and improve their productivity and international competitiveness (Dimitratos, Amorós, Etchebarne & Felzensztein, 2014; Fleury, Fleury & Borini, 2012). The need for this capacity applies particularly to Latin American firms as they have a long exporting tradition, especially to regional markets (Lopez, Kundu & Ciravegna, 2009), yet normally take a long time to become MNEs (Cuervo-Cazurra, 2008).

The process of Latin American internationalization, other than the exporting of natural resources and agricultural products, is a relatively recent development (Fleury & Fleury, 2011). This means that many SMEs are likely to be incipient multilatinas, still in the process of growing into full-blown MNEs. The factors that enable them to export successfully, and through the learning process it provides, to improve their international competitiveness, are clearly deserving of more attention from researchers. The present study therefore aims to better understand the role of exports in the mulinationalization of Latin American SMEs, as a way to learn to improve their productivity, and ultimately develop their international competitiveness before establishing FDI activities and becoming ‘multilatinas’.

The choice of Latin-American SMEs is further justified because of concerns related to their low levels of productivity relative to those SMEs from advanced economies and the recognition that their more active involvement in international business, especially through participation in global value chains, could be a powerful force for productivity improvement through exposure to technology frontiers and best practices (OECD, 2016). As the OECD and other agencies have pointed out, in many Latin-American countries, government policies to assist this process have been hampered by factors such as bureaucratic restrictions,

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poor coordination and lack of systematic evaluation of export promotion (OECD, 2016). Moreover, with few exceptions, Latin-American countries rank relatively low in terms of the KOF "Globalization Index" which assesses their interconnectedness with other parts of the world (KOF EthZürich, 2015). Indeed, a study of Brazilian clothing SMEs indicated that for many of them internationalization meant regional exporting to other Mercosur members rather than a global business reach (Seifert, 2010). This relative isolation, except for the case of Mexico, has been identified as one of the major limiting factors for the growth and success of Latin American SMEs with an international component (Cuervo-Cazurra, 2016).

The main contribution of this study is to provide a theoretical answer to the question 'How can Latin American firms overcome geographical isolation?' We develop our theoretical argument based on the work of Cuervo-Cazurra (2016) who suggests that geographical isolation of Latin American SMEs can be overcome through a shift in market priorities, i.e. from domestic to foreign markets. This is illustrated by some of the world's largest Multilatinas (i.e. Bimbo, Citrosuco, Tenaris) who achieved their international growth and success by switching from a domestic to a Foreign Market Focus (FMF), a concept first presented by Aulakh, Kotabe & Teegen (2000). Latin American firms with a FMF are likely to adopt new technology and upgrade product features to meet international standards (Serti & Tomasi, 2008) and therefore are likely to achieve productivity gains. We empirically assess this possibility by comparing the productivity gains of exporting Latin American SMEs that exhibit a higher international orientation compared to those that have a more domestic focus. Productivity gain is a measure of performance that is attracting increasing interest in the international business literature (Luo & Bu, 2016). Only a few single country studies have investigated the effect of exports on firm productivity in the context of Latin America [see Alvarez and López (2008) on Chile, Bernard and Wagner (1997) on Colombia, and Clerides, Lach, & Tybout (1998); on Mexico]. In addition, with the exception of Girma, Greenaway & Kneller (2004), previous studies have only compared the differences in productivity between exporting and non-exporting firms (Aw & Hwang, 1995; Van Biesebroeck, 2005). Therefore, our study contributes to this line of literature by comparing the differences in productivity between exporting firms only, thus eliminating the main criticism attributed to the export and productivity research, i.e. the self-selection argument.

An additional contribution of this research is that we consider the role of key moderating variables with the objective of better understanding some of the mechanisms that explain the complex relationship between FMF and firm productivity. In general terms, Latin American SMEs have faced several barriers to an active participation in global value chains (Azzi da Silva & da Rocha, 2001). For instance, Ciravegna, Lopez & Kundu's (2014) research findings suggest that due to negative country of origin effects, Latin American SMEs face more difficulties in internationalizing than their European counterparts. Our study contributes to an understanding of how exporting firms possessing an '*outward looking competence*' (OLC) that enhances their image and reputation, may improve their international competitiveness. Conversely, our study helps to understand why outsourcing export sales activities to *intermediaries* negatively affects firms' competitiveness, even though the use of intermediaries has been widely acknowledged by the international business literature as being a useful export mechanism in the region (Suominen & Volpe, 2013). A key strength of our study is the use of a large sample of 1267 exporting Latin American exporting SMEs, which enables us to test the consistency and significance of these various relationships through comparing various subsamples, i.e. by industry sector (manufacturing, etc.) as well as by country.

2. Theoretical background and hypotheses development

The increasing pace of globalisation and integration of global value chains intensifies the pressure for international expansion. In the initial stages of their internationalization process, firms tend to resort to exports as this entry mode requires lower levels of resource commitment and international market knowledge than foreign direct investment [FDI] (Johanson & Vahlne, 1977). As such, exporting becomes a particularly useful method of international development for SMEs because, when compared to large MNEs, they tend to possess a more limited resource and knowledge base (Sapienza, Autio, George, & Zahra, 2006).

The question of whether exporting firms have stronger performance than non-exporters is a core theme in international business (Wagner, 2007). The extant literature posits that exports helps smaller firms increase their size and more importantly achieve higher levels of productivity (Aw & Hwang, 1995; Girma et al., 2004; Van Biesebroeck, 2005), and provides a myriad of potential factors underpinning the presumed increase in productivity of exporting firms. For instance, Aw and Hwang (1995) found that the differences in productivity level between exporting and non-exporting firms are partly explained by the size and resource base of exporting firms. Van Biesebroeck (2005) reported that exporting firms possess higher capabilities because of the tendency to pay higher wages thereby obtain and retain better talent and are more capital intensives than non-exporting firms. Others argue that the resulting improvement in productivity of exporting firms is greatly explained by a learning-by-exporting approach, as exporting firms increase their knowledge base by learning from being involved in foreign markets (Martins & Yang, 2009; Van Biesebroeck, 2005) and enhance innovative performance (Golovko & Valentini, 2011; Salomon & Shaver, 2005). Salomon and Shaver (2005) have argued and demonstrated that the learning-by-export effect is even more evident on firm innovative performance in terms of product innovation and patents development than it is on firm productivity. However similarly to other scholars, they acknowledge that this is due primarily because of the learning-by-exporting effects, as exporting firms directly or indirectly access and absorb knowledge experientially from international markets as they interact with foreign agents, customers, suppliers, competitors and intermediaries or other type of collaborators and are exposed to know-how and technologies not available in domestic markets (Dimitratos et al., 2014; Salomon & Shaver, 2005; Voudouris, Dimitratos, & Salavou, 2011). As suggested by Wheeler, Ibeh & Dimitratos (2008), frequent utilisation of export-related information directly enhances a firm's export competitiveness. This tends to be the case because it develops greater knowledge about important export-related processes, routines and systems (Allison & Browning, 2005).

The well-established relationship between innovation and exporting among SMEs is also seen to have positive implications for productivity, whereby they jointly lead to productivity benefits (Lööf, Larijani, Cook, & Johansson, 2015; Love & Roper, 2015). According to Tse, Yu & Zhu (2015), productivity gains linked to the process of learning-by-exporting are enhanced when firms have necessary internal capabilities such as human capital, production and innovativeness. However, taken as a whole the results from the extant literature are far from clear in helping us understand what factors contribute to an increase in the productivity of exporting firms (Martins & Yang, 2009; Wagner, 2007). Whilst there is an ongoing academic debate comparing productivity levels between exporting and non-exporting firms. Yet, we know very little about the heterogeneity within groups of exporters. Exporting firms differ with each other in their productivity levels.

We argue that one of these heterogeneities is implicit in the FMF orientation. The FMF concept, introduced by Aulakh et al.