Importance of FDI in SME’s Internationalization

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Abstract
Previous research on internationalization has focused on developed economy enterprises and multinationals (MNEs). A growing number of enterprises which are now internationalizing are Small and Medium Enterprises (SMEs). The need for SMEs to internationalize has been increasing, and the consumption and production capacity of emerging nations is also significant. SMEs are key to reinforcing productivity, offering more inclusive growth and adapting to megatrends. Export and import activity is the most often used form of the global expansion of the companies of the SMEs sector. Therefore this research focused on the part played by foreign direct investment. The research aimed to explore the importance of FDI for SMEs internationalization. A systematic literature review was conducted in this research. A total of three relevant articles were selected for review. The results of this research provided evidence that SMEs which consider FDI as an investment resource appreciate the benefits of employment creation, innovation, skilled labor force, productivity growth, and competitiveness.

Keywords: SMEs, internationalization, FDI, outward FDI

Introduction
An extremely significant and remarkable phenomenon of the 21st century is the internationalization of large and small enterprises (SMEs). Next, to the fact that SMEs increasingly tend to internationalize, another unique element of globalization trend has been the remarkable rise in foreign direct investment (FDI). Yet, it is broadly acknowledged that SMEs, in general, is a subject of substantial financing limitations (Kalinic and Forza 2012). Internationalization has extended enormously with the increasing globalization and liberalization. It has allowed the transfer of capital, technology, and labor where they are anticipated to be ideally used. SMEs in developed nations are facing fierce competition, and in order to expand and survive, they are compelled to make a move beyond the domestic marketing considering market expansion prospects (Lee et al., 2012). For SMEs, crossing the national boundaries in the production, procurement or sales open up new opportunities and create an incentive to become more productive and innovative.

Firms which are active internationally are more competitive than their domestic counterparts (Hitt et al., 2016). They get benefits from access to technology, awareness, increased efficiency, economies of scale and increased competence through entering into challenging markets and exploiting the benefits of innovative technologies. Given this improved market incorporation, SMEs play a vital role in worldwide value chains (Lin & Ho, 2018). The advantages of internationalization not only flow from exporting but from all kinds of international activities. Imports, for instance, can boost performance by offering access to cutting-edge technology and capabilities. FDI, technology transfer, participating in international value chains and other kinds of SME cooperation are also gaining ground (Child & Hsieh, 2014). In all cases, the firms are seeking a greater competitive edge, technology access, and more readily accessible inputs.

Lately, SMEs have been playing a dynamic role in global markets and using international diversification as a vital strategic option for achieving growth (Sui & Baum, 2014). This research topic also brings some of the most common concepts and models such as Uppsala Internationalization Process Model, International Entrepreneurship, Network Theory, as well as interesting phenomena of today’s complex business landscape such as Born Globals or International New Venture (INVs). Importance of FDI for SMEs have received comparatively less academic attention, and less effort has been devoted to analyze the impacts (Banno &
Sgobbi, 2010). Therefore this research tries to explain the impacts FDI can have on SME’s internationalization. The purpose of this study is to gain better insights into the internationalization of SMEs, particularly the use of FDI. This research paper is focused on one of the methods for supporting the SME sector in a situation of lack of resources. Particularly, this paper explains the possible role of FDI in relation to internationalization of SMEs.

Literature Review
This chapter will explain the importance of FDI for SMEs from an international perspective. Different countries have been compelled to turn to FDI as a means to avoid development financing constraints as there are an increasing gap and decline in FDI during recent years. Internationalization is significant for SMEs to develop in a progressively competitive landscape and add to sustaining occupation (Costa et al., 2016). As a part of their development strategy, most of the companies choose to increase their geographic range from local to international markets. Internationalization is a vital choice for small and medium firms which usually have a minor financial base, local focus, and restricted geographic range. Traditionally, FDI role was to preserve the larger firms, both in developing and developed nations (Thompson & Zang, 2015). Though, there is increasing evidence of variation in these patterns of FDI, involving a wide range of sources and home countries and increased involvement of SMEs. According to Galkina and Chetty (2015) technological landscape and the uncertain environments, nurtured by the decline in trade obstacles, together with the reduced cost of transport and communication, have led SMEs to become actors on the global scene. According to Cavusgil and Knight (2015), business internationalization can be explained as a sequence of business activities outside the national border that is centered on applying the idea of international marketing. Foreign direct investment (FDI) is explained as cross-border speculation through the local company in one economy with a goal of gaining an interest in the local company in another economy (Demir, 2016). The long-standing interest suggests the presence of long-standing relationships among the direct investor and the enterprise. FDI is divided into two types; outward and inward which outcome in net inflow (whether positive or negative).

FDI has played a significant role in globalization and also allowed many developing nations to quicken their growth (Yang et al., 2017). The advantages of inward FDI have been widely analyzed and researched empirically in the literature. FDI is a critical aspect of international economic integration. It is an additional backing investment source, and with the correct policy situation, it could be a vital network for the growth of SMEs (Pradhan & Singh, 2017). Better FDI inflows in a country can help generate positive impacts on the economy. According to OECD, FDI is a necessary part of a global and open economic system. It is a major catalyst for development. SMEs account for almost 95% of the firms and around 60%-70% of job generation and share of new jobs in OECD countries. SMEs contribute to around 25%-35% of the world’s trades of manufactures and account for a minor share of FDI (OECD, 2018).

Small and medium enterprises form a vital source of dynamism and growth both for developed countries and emerging economies (Robu, 2013). Much of the previous literature on the internationalization of SMEs were encouraged by the common advertising theories. Later on, internationalization apportioned with the choice among exporting and FDI (Cassiman & Golovko, 2011). Though exports have prospective benefits over FDI for arriving in overseas markets, there are also some drawbacks related to it (Kinda, 2010). For goods such as soft drinks, the capacity to value ratio is greater, and expenses of transport might be substantial in distributing these products (Lu & Beamish, 2006). Furthermore, trade regimes and tariff barriers by the host country’s government can affect the net profits accomplished by exports (Handley, 2014). Based on how firms assess the comparative influence of such situations FDI can be a better way to enter foreign markets and achieve firm growth. This comparison among FDI and exporting suggest that FDI is a more active internationalization approach for SMEs, particularly when their competitive edge is exclusive assets. Foreign direct investment widens a firm’s client bases over entry into new marketplaces, allowing the firm to accomplish large production volumes and grow (Lu & Beamish, 2006)

According to Wagner (2012), robust contribution by SMEs in the global marketplace generate opportunities to scale-up and increase productivity by accelerating innovation, facilitation technology spill-overs, managerial
know-how and broadening the skill set. Exposure internationally whether through exports, imports or FDI, goes hand in hand with high productivity and is an important driver of growth in employment. Outward FDI offers SMEs access to international marketplaces and integrates into the global value chain, as upstream suppliers to exporters (OECD, 2015). The previous literature indicates that closeness to global enterprises, though this kind of internationalization is uncommon among SMEs. A survey conducted on European SMEs in 2009 revealed that only 2% of the direct investment abroad. The empirical evidence also suggests that public measure for supporting outward FDI by SMEs are practical for enhancing their performance in terms of growth and domestic turnover, particularly for smaller firms (Banno et al., 2014). The economic concept suggests that FDI can produce progressive spillovers to local firms in the host country (Gorodnichenko et al., 2014) as multinational corporations (MNEs) are a significant source of global technology and capital. Their entrance can simplify the transfer of technical business awareness leading to competence gaining and effectiveness among resident companies mainly SMEs. All these impacts develop through demonstrating best practices, or through creating the linkage with overseas and local companies developing into either customers or suppliers or with the movement of skilled workers from overseas to local companies.

FDI is direct investment and a major force for development and growth. FDI brings technology, capital, and knowledge straight to the host country (Bende, 2017). The key notion underlying the FDI policies and FDI promoting effects of global donors such as IMF and World Bank is that FDI inflows nurture economic growth (Azman et al., 2010). Some of the major potential benefits of FDI include the transfer of knowledge, technology, employment generation, and human capital, as well as enterprise development and effects through linkages and spillovers. Moreover, the additional capital source is visibly important in nations where monetary barriers act as a constraint for development (Bende, 2017). Advancements in ICT and logistics systems reduced barriers to trade, deregulations in markets and establishment of EU single markets have reduced the exporting cost and offered SMEs an opportunity for entering the foreign markets.

Methods/Materials

The research methodology used in this research is exploratory research. Exploratory research is used for investigating a problem which is not clearly defined. This type of research is conducted for understanding the existing problem and offering conclusive outcomes. In this research, the researcher might be willing to change the direction of the subject to the revelation of new data and insights regarding the importance of FDI in SME’s internationalization. It is often referred to as grounded theory or interpretive research (Reiter, 2017). This research used secondary research for collecting information from previously published primary research. In this research, the author gathered information from literature, books and case studies. The systematic literature research methodology is applied in this research. A systematic review uses systematic methods for identifying, collecting and critically appraising all the relevant research. It involves the collection and analyzing information from the studies which are incorporated in the review (Petticrew & Roberts, 2008). Sources include books and journal articles from the library, government websites, and annual reports and published statistics. A broad search for literature was performed using electronic components. The electronic search was performed using OECD, Political Science Complete and Business Source Complete databases (2006-2018). Following search terms were used: FDI, SMEs, and internationalization. Inclusion and exclusion criteria used in the research was the date of the publication, type of research design and language of publication. During the screening, abstracts were reviewed thoroughly for selecting the articles. Full articles were obtained from years 2006-2018. A total of 3 relevant research papers along with the supporting literature were selected to discuss in details a theoretical overview of the role FDI play in SME’s internationalization. The reason for choosing only three papers is because there is very limited research regarding the importance of FDI for SMEs internationalization. During the first search, from 26 articles, only three appeared relevant to the research topic. The articles selected were “Foreign Direct Investment and SME Development: Some Policy Issues for Transition and Developing Countries” (Smallbone, 2006), “The FDI of Small - and Middle-Sized Enterprises: A Literature Review” (Pu &
Zheng, 2015), and “The impact of foreign direct investments on SMEs’ development” ((Tuluce & Dogan, 2014).

Results

The research conducted by Smallbone (2006) stated that SMEs play a significant part in economic progress and growth as well as contribute to poverty mitigation through generating employment. Role of FDI in relation to the enduring competitive growth and internationalization of the SME sector in provisional and evolving countries is critical. This research article is concerned with ways which can strengthen the local SME sector in a situation of scarcity of resources. This article talks about the role of FDI for long-term competitive development and internationalization of SMEs. There are several trends which suggest that there is a scope for evolving such links in the near future. It includes the emergence of new FDI sources and predictions of SMEs internationalizing their processes rather than exporting. SMEs that invest overseas self-sufficiently also tend to capitalize on physically close regions (Smallbone, 2006). The causes for this include their limited information fields and resource limits as compared to larger firms. The positive spillover is the most strong and consistent situation of backward links, with local suppliers in the developing countries. Small companies with a high proportion of skilled labor are likely to benefit from positive spillovers (Cravo et al., 2015). For internationalization, SMEs need to be productive enough to overcome the fixed costs of setting up an affiliate in another country and to compete successfully against market incumbents (Mayer & Ottaviano, 2008). Foreign firms hold operational, technical and managerial knowledge which local firms can tap into and enhance their productivity through productivity spillovers. FDI also ease up the capital constraints as SMEs are severely affected during economic crises. FDI can ease up capital constraints by market-based financing suggested by OECD (OECD, 2015). This report showed that using a financing instrument rather than bank debt improved the operating environment for SMEs. The researcher also highlighted the productivity gains which SMEs enjoy through FDI. When suppliers are able to produce specialized inputs, SMEs have bargaining power. Such kinds of linkages are often based on mutual specializations going beyond arms-length transactions. They might involve in a long-term commitment with the transfer of knowledge and technology.

Another research conducted by Pu and Zheng (2015) indicated that SMEs started internationalization and FDI become a significant approach to contribute to global activities. As the traditional FDI theories outline a little about FDI activities of SMEs, this papers reviewed the literature about SMEs and FDI. SMEs often lack in product development, technology advancement, funding, human resources, managing experiences and risk tolerance (Zahra et al., 2007). Knowledge-extensive small and medium firms do not follow the old stage model but featured with “leapfrog.” In addition, the concept of “Born Global” and “International New Ventures” challenged the traditional FDI theory (Zhou et al., 2007). In this research, the author highlighted different theories about the reasons for conducting FDI. The author used a small scale technology theory, an international new venture, and international stage theory. While making investment decisions, SMEs are often more sensitive than large companies in the host country’s environmental factors; the host countries are required to elevate their infrastructure and legal rules to attract investment from SMEs. FDI diversify an investor’s portfolio and provide financing and advanced technology to SMEs (Lugemwa, 2014). In this article, the author failed to explain the benefits of FDI for SMEs. There is also a shortage of detailed analysis of the internationalization patterns of SMEs.

According to Banno and Sgobbi (2010), outward internationalization is developing into an increasingly significant aim of public interference in most of the OECD nations. Governments have introduced different home country measures with tools such as fiscal interventions, financial backing, investment protection, access to information and mechanical support for mitigating the failure in information and coordination (Kazlauskaitė et al., 2015). FDI involves a commitment for foreign resources, but it is less flexible when it comes to dealing with investment threats such as different market circumstances. Particularly the dynamic elevation of outward FDI depends on non-financial as well as a financial measure targeting to ease market failures, uncertainties, and
risk such as shortage of assets and abilities in a firm undertaking investment in a foreign environment (Pradhan & Singh, 2017). The results of this research supported the notion and temporary financial support for SMEs might not be effective leading to market distortion. The fundamental state is that SMEs must be well-versed about different sources of support and financing accessible to them, and here, policymakers can play a role. The empirical evidence suggested that SMEs are required to improve capabilities for accessing FDI, which in turn might activate other distinctive competencies to grow internationally. FDI generates unswerving, steady and continuing links among economies (Tuluce & Dogan, 2014). It encourages the relocation of innovative technology and knowledge among nations and offers the host economy to encourage its products more extensively in global marketplaces (Zhang et al., 2016).

Another research article selected for this literature research is concerned with the impact of FDI on the growth of SMEs. In this research, the author surveyed the current theoretic and empirical literature but limited the focus on productivity changes which are induced by the increased inflow of FDI. The aggregate productivity effects and spillovers effects of FDI on SMEs were also examined (Tuluce & Dogan, 2014). FDI plays a dynamic part in improving the economic development of a country. Along with offering the benefits of capital saving and manufacturing capability of the host nation, FDI also brings management and technological skills (Newman et al., 2015). FDI has a constructive impact of balance of payments, and it serves as in influential tools for policy related to economic integration (McCombie & Thirlwall, 2013). The benefits of FDI to domestic economies have been studied extensively in the literature. The standard international trade theory viewed investment abroad as mediating capital. With this opinion, the gap between the marginal product of labour and capital will be diminished by FDI (Sornarajah, 2014). In a neo-classical model of economic development, increase in workforce and capital stock adds to high economic growth. Consequently, the FDI flow, by growing the local capital stock, will rush to increase the development of the economy. More considerably, it has often been debated that FDI adds to progress beyond the straight effect of growing the capital stock (Almfrai & Almsafir, 2014). FDI is also viewed as bringing a multitude of benefits for the host country including new technology, accessibility to the international market and opportunities for managerial knowledge (Yoo & Reimann, 2017). Prospects of these additional benefits are part of the motive why governments in emerging countries offer distinct incentives to draw FDI. Current research provides proof for approaches in developing countries that positively turned FDI into quality FDI. The notion underlying these recommendations is to learn the lessons from experience (Moran, 2014).

**Discussion**

FDI and outward direct investment are important ways to increase the flow of people, trade and innovative ideas (Cozza et al., 2015). Outward FDI help SMEs to get exposure in overseas markets, knowledge, and ideas. FDI also help in attracting international talent to lift skills in the labor market, as well as intellectual property and resources for research and development (Meyer & Xin, 2018). FDI also help SMEs in increasing the skill levels in their workforce, including the critical areas such as technical specializations and management (Lugemwa, 2014). According to Wang (2015), FDI offers direct effects on the performance of SMEs. Foreign investors are most productive, implying that they own some ‘firm-specific advantages’ which make them competitive. Investing firms can transfer knowledge and skills, including innovation and managerial capabilities. They can provide access to global networks and supply chains.

Foreign direct investment is a critical factor in worldwide economic combination. FDI generates direct, steady and ongoing links among economies (Lall & Narula, 2013). Since FDI involves important possession regulation as well as the relocation of exemplified and intangible technology, its influence on economic development can take place through better productivity, gathering human capital research and development actions as well as technical and production spillovers (Gorodnichenko et al., 2014). FDI exerts positive spillovers on local companies with increased initial output: the system effect channel and the labor mobility channel. Particularly, firms that are capable of hiring executives and engineers from foreign companies have
high efficiency. It is supportive evidence that labor flexibility offers a network for FDI spillovers. Moreover, SMEs which hire young and more trained labor force to be apt to have high efficiency and there is more occurrence of FDI in their industry (Xu & Sheng, 2012). FDI in most of the countries is considered as a vital element of growth strategy and policies. Presence of FDI can improve the quality of the workforce, infrastructure, R&D and would have long-lasting positive impacts. The gaps regarding funding are a major impediment for the growth of small and medium enterprises. Broad variance in profitability, growth, and survival of SMEs as compared to the large firms pose different financial constraints (Kuivalainen et al., 2012). Managers and owners of small companies often lack experiences and managerial skills. Smaller firms operate in a highly complex environment and depend on intangible assets. SMEs often face trouble acquiring finances as banks and traditional lending institutes are averse to risky projects. The spillover of knowledge and technology from FDI to the incumbent business sector is the key advantage of FDI to growth (Sawada, 2010). FDI represents a possible means of diversifying and growing the SME base and accomplishing integration in the global networks. In order to make a robust association among FDI and SME, policies for boosting this link must be multidimensional. This is the major reason why most of the policy makers in developing nations pay close attention to the broad business landscape which affects the development of SMEs and their capability to attract FDI. Irrespective of different understanding, SMEs internationalizing theory is still inconclusive. This research suggests that for attaining a holistic understanding internationalization of SMEs and the role of FDI, a broad range of internationalization theories are required.

Conclusion
In this research, the author studies the importance of FDI for SMEs internationalization. The results of this exploratory research suggest that FDI is considered as the most significant factor in the development of SMEs. During the recent years, most of the SMEs started to internationalize, and FDI became a substantial approach for SMEs to participate in international markets. This research paper reviewed the related literature about the role FDI play for SMEs internationalization. This research aimed to add to the empirical and theoretical research of SME internationalization, its facilitator (FDI) and its impact on a firm’s performance. The research summarised the past literature of SME internationalization, its effects, and motivations. SMEs experience more resource and financial restraints with respect to information, technology and management capability, as well as external obstacles such as market protocols and imperfections. Therefore, they tend to resort more often to internationalization. There are certain limitations in this research such as lack of recent and available data on benefits of FDI for SMEs, lack of prior research studies related to the topic. The results of this research cannot be generalized as the internationalization of SMEs is affected by government policies, industry structures, market conditions, internal resources and capabilities across different countries. There are still gaps in the literature as well as potential empirical evidence on the role FDI play in SMEs internationalization. Although this research has presented robust findings with respect to the benefits of FDI and internationalization of SMEs, avenues are open for further investigations.

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