

# The FDI of Small- and Middle-Sized Enterprises: A Literature Review

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## Abstract

In recent years, increasing SMEs (small- and middle-sized enterprises) started internationalization, and FDI became an important approach for SMEs to participate in international activities. As traditional FDI theories explain little about the FDI activities of small and medium companies, the paper reviews the related literatures about the FDI of SME, classifies the motives of conducting FDI, elaborates the decision-making process, concludes the investment performance and summarizes the related empirical studies and the defects of existing literature.

## Keywords

Small- and Middle-Sized Enterprises, FDI

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## 1. Introduction

In terms of FDI theory, we need to explain the two issues of “why” and “how”. The traditional theories explained that “why” mainly includes the monopolistic advantage theory based on imperfect competition proposed by Hymer [1], the product life cycle theory proposed and developed by Vernon [2], the trade and investment theory based on marginal comparative advantage proposed by Kojima [3], internalization theory based on transaction cost proposed by Buckley and Casson [4], and the internalization theory based on OLI-Model proposed by Dunning [5] [6]. The traditional theories explained that “how” mainly includes the vertical and horizontal FDI theory based on industrial organization proposed by Caves [7], and the innovation model proposed by Johanson and Vahlne [8] [9].

However, these theories and models explain little about the FDI of small and medium enterprises for the two reasons: first, they contain an implicit assumption that the study object is large enterprise; second, SME lack of the advantages in product and technology development, financing, human resources, information acquisition, management experience, marketing strategy and risk tolerance. SMEs, knowledge-extensive SMEs in particular,

do not strictly follow the traditional stage model, but featured with “leap frog”. Moreover, the conceptions of “Born Global” and “International New Ventures” proposed by Knight [10] and McDougall and Oviatt [11] challenged traditional FDI theory. Traditional theories might vaguely explained the motives and modes of SME’s FDI, but some modern theories proposed by Buckley, Liesch and Knight, Hollenstein provided some new perspectives and made up the deficiency [12]-[14].

In accordance with the traditional theory, the representative SME theory also needs to explain the two issues of “why” and “how”.

## **2. Theories about the Motives of SMEs Conducting FDI**

### **2.1. Small-Scale Technology Theory**

In accordance with Small-Scale Technology Theory by Wells [15], the enterprises in small-scale markets like developing countries are featured with higher flexibility and lower technology costs, which enable them to capture the market with a faster speed and a lower price. In comparison to SMEs, the multinationals respond slower since the scale effect usually acquires longer time.

### **2.2. Entrepreneurship Theory and International New Ventures**

Rennie, McDougall and Oviatt proposed International Entrepreneurship Theory. It argues that SME’s internationalization mostly attributes to entrepreneur’s international vision and international experience, their internationalization development is either proactive or reactive [11] [16] [17]. McDougall and Oviatt define general international entrepreneurship as “a set of behaviors conducted by commercial organization in order to accomplish the goal of organization value creation, including creativity, initiative and risk taking moves [18].” Scholars often combine Entrepreneurship theory and International New Ventures together to explain the internationalization behaviors of the younger and smaller companies.

According to McDougall and Oviatt, while other competitors start internationalization long after establishment, few new ventures follow the conventional market entry procedures [18]. Thus, new ventures could utilize learning abilities to achieve rapid growth in host countries. McDougall and Oviatt mentioned that most new ventures are founded by entrepreneurs with international experience and international market prospective [11]. Their education background, work experience and personal thoughts play a decisive role in the company’s internationalization development. Knight concludes that better enterprises have stronger tendency to change marketing strategies when entering new markets, and in SMEs, entrepreneurship have more profound influence on enterprise’s globalization process [19].

### **2.3. International Stage Theory**

Uppsala model is the core of international stage theory, it divides the internationalization of enterprises into four stages: no regular export activities, export via independent representatives, establishment of sales subsidiary, production or manufacturing. International stage theory explains enterprises’ internationalization without regard of size and scale, After the empirical analysis, Bilkey, Johansson and Nonaka found that SMEs’ internationalization showed significant periodicity in operating activities [20] [21]. Yip and Biscarri analyzed the newly internationalizing firms, which do not follow a systemic approach, but the following six steps: Motivation and strategic planning, market research, market selection, entry mode selection, infrequent events and issues of planning, strategy and investment of resources supplement [22].

## **3. Theories about Decision-Making Process and Approach**

### **3.1. Network Theory and Social Capital Theory**

Johanson and Vahlne proposed an international enterprise network model, which indicated that the process of internationalization of companies is a cycle of using knowledge, resources to establish, develop, maintain and end the process of network relationships [9]. Johanson and Mattsson, Coviello and McAuley, Dunning think there are two approaches for SMEs to strengthen network abilities and achieve internationalization: one is to establish new social connections and build strategic alliances by utilizing the internal network resources like interpersonal, technical, economic, legal relationships; The other is to integrate into the existing network relation-

ships [18] [23]-[25]. Some scholars indicated that SME can take advantage of the existing network relationship or value chain to establish new branch or start an international investment in other countries, which leads to a gradual increase in the enterprise networking capabilities. For instance, some SMEs gain investment channels from their overseas suppliers. Moreover, SMEs can also build their own networks through enterprise clusters to reduce transaction costs, increase productivity, and promote the information flows. The individual interactions strengthen abilities to integrate resources, enhance industrial competitiveness, promote industrial upgrading and boost innovation.

### 3.2. Social Capital Theory

Social capital theory, on the other hand, indicated that social capital is the formation of network link composed by social resources and relations, which has a significant impact on the embedded economic activities [26]. Scholar Chow thinks that social capital could lower transaction cost and operating risks while obtaining information and resources, he divides social capital into three dimensions, including structure, relationships and embedded cognitive social capital [27]. Karagozoglu and Lindell argue that social capital often provides enterprises with critical resources and information. The opportunities and decisions of SME internationalization are related to social capital, SMEs can take advantage of the international development of social capital, and promote the formation of international market experience and knowledge, in order to select the appropriate market entry mode, timing and development model [28].

### 3.3. Resource-Based View

Some scholars explain the motivation of SME FDI with the Resource-based View in Enterprise Management Theory [29]. RBV indicates that the core competitiveness of enterprises is the tangible and intangible resources. They are uncertain, complicated and inimitable but sometimes benefit SME's entry to international market [30]. According to RBV, there are four types of resources that determine SMEs' entry to international market: general human capital resources, the principal founder's management know-how, the principal founder's specific industry know-how, and a principal founder's ability to obtain financial resources that can act as a buffer against random shocks [31]. In comparison to large enterprises, SMEs have advantages in entrepreneur experience, cost, adaptability, learning speed and innovation capacity [32].

Based on the Resource-based View, some scholars use knowledge resources to build a more comprehensive model to explain enterprises' development. Knowledge resources are important comparative advantages which enable SMEs to start internationalization quickly [33], and SMEs are largely dependent on knowledge resources to develop new products, services and international markets [34]. Mejrind Umemoto proposed a knowledge-based model to explain SMEs' involvement in internationalization, which included the following "knowledge factors": the market knowledge and the experiential knowledge composed of network knowledge, cultural knowledge, and entrepreneurial knowledge [35].

### 3.4. Global Value Chains and Global Production Network Theory

Kaplinsky and Readman indicate that SMEs need to go through various processes and standards to join the global value chain, which requires a high fixed cost [36]. However, SMEs still participate in global value chains through a variety of flexible and efficient ways like cooperating with downstream enterprises. Under most circumstances, SMEs get involved in global value chains through joining industrial clusters [37]. Giuliani, Pietrobelli believe that the competitive difference between SMEs originates from their abilities to "upgrade" and "improve", and this competitiveness is often manifested in the ability to innovate or increase the added value of products [38].

Kaplinsky and Readman divide the SMEs in global value chain into two types: buyer-driven chain and producer-driven chain [36]. In buyer-driven chain, SME can conduct FDI through corporation with local enterprises or build transactional corporations; in producer-driven chain, SMEs can join industrial clusters or vertical value chain to achieve mutual cooperation and improve collective efficiency, which can effectively overcome the shortcomings of scale, capital and so on. With the accumulation of international experience, most SMEs' role have gradually transferred from low value-added production processes (such as OEM, OEA) to high value-added, knowledge-intensive and high return rate of ODM (original design manufacturer) or OBM (Original Brand manufacturers).

## 4. Empirical Analysis of FDI on SMEs

### 4.1. Analysis about Basic Situation

Buckley, Berkova, Buckley and Newbould summarize FDI scale, orientation, and industry and product characteristics by UK SMEs [39] [40]; Based on the findings of regional classification analysis, Fujita summed up the patterns and trends of SMEs FDI in multiple countries, including investment location, industry choices and so on [41]. His findings include the following statements: SMEs are more focused on investing in developed countries, while investment in developing countries is relatively less; Southeast Asia is a major host country for SMEs; SME's investment range is wide, but most concentrated in electronics, chemicals, textiles, services, and non-equity investments. Óladóttir investigates the FDI motivation, location, mode and trend of NASDAQ-listed SMEs in Iceland, then draw the conclusion that most overseas investment by SMEs are due to the limited local market and the attraction from potential markets, and they often chose larger enterprises as investments [42].

### 4.2. Analysis about Driven Factors

Kuo and Li use risk model to analyze internal factors (R & D intensives, firm sizes, export ratios and capital intensives) and external factors (resource foundation, relationship network, following markets and strategic considerations) [43]; And conclude that SMEs with a lower degree of capital intensities, a larger firm size, a higher export ratios and a larger level of R & D intensities will have a greater intention to undergo FDI. Hollensteines uses multi-log it model to testify each series of factors in OLI paradigm that affecting FDI on SMEs [14]. He discovers that ownership advantages (O-advantage) are the main driving factors of SMEs' internationalization; location advantages (L-advantage) contribute the FDI of smaller enterprises more obviously; the role of internationalization advantages (I-advantage) is not clear.

### 4.3. Analysis about Investment Decision-Making

Urata and Kawai, Jaklič and Svetličič, Wilson use logit model to analyze the barriers of SMEs' FDI from home and host countries [44]-[46]. When making investment decisions, SMEs are more sensitive than large enterprises in the host country's environmental factors, the host country needs to upgrade the hardware (infrastructure) and software (legal policy) both to attract investment from SMEs; Cheng and Yu conduct correlation analysis by questionnaire, then analyze the internationalization decision-making process with the changing institution and external pressure, which is sensitive to the changes of institutional environment from home country [47]. Johnson and Arya use questionnaire and CMV (Common Method Variance) to study the global integration strategies of Taiwanese SMEs in IT industry [48]. They find the negative relationship between competitive actions and business unit integration. Wei and Christodoulou study the decisive factors during SMEs' foreign investment decision-making process, including human resources, ownership network, the host government and information collection [49]. They believe that FDI is a gradual process of learning, SMEs should gradually accumulate experience during FDI decision-making process.

### 4.4. Analysis about Location Decision

Fujita analyzes the main factors of the host country to attract FDI of SMEs in Japan [41]; Chen uses multivariate analysis of variance to study the FDI location decisions of SMEs in Taiwan, find that Taiwanese companies are keen to establish external network connection instead of internal network [50]. When making location decisions, SMEs are more sensitive to networks than large enterprises.

Li and Hu study the relationship between the regional technical efficiency and Taiwan SME FDI location through theoretical model and multiple factor analysis [51]. They find that Taiwanese SMEs with higher technical efficiency are more likely to conduct FDI in China mainland. In other countries, however, the relation between technical efficiency and FDI location is not significant. Dhungana analyzes the SME development in Asia region. Compared to large enterprises, SMEs have better flexibility and adaptability, faster decision-making speed and closer customer relationships, their labor-intensive technology is more conducive to explore other community markets in developing countries [52].

### 4.5. Analysis about Financing Constraints

De Maeseneire and Claeys analyze the reasons and forms of financial constraints about Belgian SMEs conduct-

ing FDI [53]. They think financial constraints would not only restrict the international development of SMEs, but also affect the development of home country and host country; Bannò, Piscitellouse two-step treatment effect mode, comparing the features and financing methods of the firms that benefited from public support with a group of firms that also internationalized their activity in the same period but without any incentive [54]. They find that the public support and incentive play a more significant role on SMEs with internationalization experience, especially the smaller and younger ones.

#### 4.6. Analysis about Performance

Beamish and Lee used multiple regression analysis to study the characteristics and performance of SMEs in Korea branches in emerging markets and have following findings: compared to establish a wholly owned subsidiary, the Korean SMEs are more inclined to adopt a joint approach to establish a branch, and the control degree by parent company has a decisive impact on their performance [55]; Cheng and Yu use ANOVA (Analysis of Variance) to study the overseas branches of Taiwanese SMEs from the perspective of institutional theory [56]. The results show that their operative activities are restricted to parent companies. Musteen, Francis study how the international network influence the international speed and performance of SMEs in Czech, they find that SMEs with diverse networks in different regions would have better internationalization performance, over-reliance on interpersonal networks will discourage international new ventures investments [57]. Vachani analyzes the problems that the foreign affiliates in Japanese SMEs encounter during internationalization, and indicates the importance of institutional issues (institutional distance, legality, etc.) as well as factors that FDI theory suggests are related to multinationals, such as industry concentration and high technology [58]. Lu and Beamish analyze the relationship between FDI of Japanese SMEs and their performance, they use ROA (Return on Assets) and ROS (Return on Assets) as measurements respectively [59]. The results show that FDI is positively correlated to business growth, but a U-shaped relationship with profit margin. Moreover, export activities have a positive effect in regulating the growth of FDI in relation to the business.

### 5. Conclusion

The above literature review shows that the present study of SMEs FDI has the following deficiencies: 1) lack of the analysis to explain SMEs' involvement in FDI from the perspective of the evolution of the international division; 2) lack of the analysis about SMEs internationalization pattern from perspective of heterogeneity; 3) lack of the social effects analysis of home and host countries as well as analysis of the similarities and differences with the large multinationals; 4) lack of the analysis about the characteristics of industry that SMEs conduct FDI; 5) lack of the analysis about SMEs in services while the service sector SMEs often have a higher internationalization degree than manufacturing.

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