Available online at www.sciencedirect.com
SCIENCE DIRECT
ELSEVIER
International Business Review 14 (2005) 415–439
INTERNATIONAL BUSINESS REVIEW
www.elsevier.com/locate/ibusrev

Problems of foreign subsidiaries of SMEs compared with large companies

Sushil Vachani*

Strategy & Policy Department, Boston University, 595 Commonwealth Avenue, Boston, MA 02215, USA

Received 28 March 2003; received in revised form 14 March 2005; accepted 16 March 2005

Abstract

This paper draws on institutional theory, supplemented with foreign direct investment (FDI) theory, to explain the level of problems encountered by foreign subsidiaries of Japanese small- and medium-sized enterprises (SMEs) and compares them with large companies. The study confirms the importance of institutional factors such as institutional distance, legitimacy, and the state's coercive influence, as well as factors that FDI theory suggests are associated with multinationals, such as high technology and industry concentration. SMEs differ from large companies in some of the operational areas in which their foreign subsidiaries face high levels of problems, but both seem challenged by problems with labor and low-price foreign competition.

Keywords: SME; Institutional theory; FDI; Subsidiary; Multinational

Firm internationalization has interested academics, companies, governments, developmental agencies and others for decades (Vernon, 1971; Wilkins, 1970). More recently, interest has focused on internationalization of an important subset of companies, small- and medium-sized enterprises, or SMEs (Coviello & McAuley, 1999; Lu & Beamish, 2001; Oviatt & McDougall, 1994; Thorelli & Tesar, 1994; Zahra, Ireland, & Hitt, 2000). This interest stems from the fact that SMEs have ventured abroad increasingly, for reasons such as lower foreign-market barriers and harsher domestic conditions, and are viewed as contributing significantly to economic growth

* Tel.: +1 617 353 4406; fax: +1 617 353 5003.
E-mail address: svachani@bu.edu.

0969-5931/$ - see front matter
doi:10.1016/j.ibusrev.2005.03.002

and employment (Acs, Morck, Shaver, & Yeung, 1997; Chen & Martin, 2001; Japan Small Business Research Institute, 1996; Reynolds, 1997).

As SMEs invest abroad, some encounter severe problems (Vachani, 1998). The challenges faced by subsidiaries of small and large companies are not always similar since SMEs differ from large companies in important ways, such as experience with foreign environments, ability to withstand demands of host governments, and level of resources available to manage foreign operations. Hence, it is important to study the problems encountered specifically by SMEs' foreign subsidiaries. This research focuses on the problems of Japanese SMEs' subsidiaries because the rise in the yen and Japanese wages in the 1980s, and the severe recession of the 1990s (Aggarwal, 1999), have motivated Japanese SMEs to invest abroad in large numbers (Japan Small Business Research Institute, 1996; Lu & Beamish, 2001).

Research on SME internationalization falls into two streams, new ventures becoming international, and the international activities of established SMEs (McDougall & Oviatt, 2000). The first has examined the antecedents and effects of internationalization (Oviatt & McDougall, 1994; Zahra et al., 2000). However, the link between internationalization and performance has not been adequately explored (McDougall & Oviatt, 1996). The second stream includes extensive research on export behavior and performance (Beamish, Craig, & McLellan, 1993; Westhead, Wright, & Ucbasaran, 2001). It also includes some research on antecedents and processes of foreign direct investment (FDI) (see Coviello & McAuley, 1999, for a review). However, research on effects of established SMEs' FDI is sparse. Lu and Beamish (2001) contend, "… more attention should be devoted to exploring whether and how value is created in the internationalization of SMEs." Chen and Martin (2001) also stress the need to study established SMEs' FDI.

Recent research has stressed the importance of the context in determining the strategies and success of multinational enterprises[1] (see for example, Andersson, 2004). This research draws on Granovetter's (1985) 'embeddedness' perspective, recognizing that multinationals operate in complex contexts, different aspects of which can create problems for their subsidiaries' operations and affect their performance. Researchers have recommended an inter-disciplinary and multilevel approach for understanding complex organizational phenomena such as the operations of multinationals (see for example, Kostova, 1999; Thorelli & Tesar, 1994). The theoretical model attempts to capture some of the complexity of the context in which SMEs' foreign subsidiaries are embedded, by drawing on institutional theory (North, 1990; Scott, 2001), and supplementing it with foreign direct investment theory (Buckley & Casson, 1985; Dunning, 1988; Hymer, 1976), to help identify factors at the country, industry and company level that help explain the problems encountered by Japanese SMEs' subsidiaries.

One reason for sparse research on effect of SMEs' FDI is the unavailability of financial performance data, which limits the samples and variables researchers can use.

[1] It is appropriate to refer to SMEs that engage in FDI as 'multinationals' while remembering they are different from 'conventional' multinationals not just in size and reach, but in other ways that are still being researched. While Vernon (1971) studied large multinationals because they were the ones governments were anxious about, he recognized smaller companies also go international: "[t]o be sure, enterprises of more modest dimensions have been known to develop a multinational structure." (Vernon, 1977: 19–20).