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Liability of Foreignness: Asset or Liability on Malaysian SMEs Perspective

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ABSTRACT

The internationalization process involves the expansion of businesses into a new geographic region and it encourages domestic growth and value-creation of SMEs. Then, it comes to the liability of foreignness effect, which has a huge impact on the operation of SMEs abroad. Foreign firms will endure additional costs arising from the unfamiliarity with new market environments, which is known as the 'liability of foreignness'. Conceptually, the liability of foreignness appears when SME's knowledge and capabilities are narrowed and differences occur in the new market. These challenges occur when a firm first enters a new market with the differences in respect of political, economic, legal and cultural dimensions. Due to this matter, firms need to adapt to the differences by changing their business strategies in a domestic-context. This concept draws from Erickson et al. (1997), who studied the importance of experiential knowledge for the internationalization process. They postulated that firms engage with liability of foreignness in the initial stage of the internationalization process. Besides, firms will suffer the negative effect of the liability of foreignness in terms of reduction in the economics of scale and the initial learning costs, which lowers firm performance. This paper aims to highlight the importance of identifying the existing liability of foreignness on the survival of Malaysian SMEs.

1 INTRODUCTION

There are many challenges faced by small and medium-sized businesses (SMEs) around the world. Studies have found that SMEs face a range of different barriers (Wan, 2003; Stuti, 2005). According to Wan (2003), SMEs face tremendous barriers, either domestically or globally, such as shortage of workforce, financial scarcity, lack of managerial capabilities, less of enforcement in high technology and high bureaucracy. These challenges have a negative impact on Malaysian SMEs, whereby, there is a gradual reduction in the number of SMEs involved in internationalization.

Hymer (1960; 1976) conceptualized liability of foreignness (LOF) as an additional cost that firms need to bear when dealing with international businesses abroad. The insight of LOF seen as firms confront either economical or social costs when dealing in foreign markets. Hence, unfamiliarity, relational and discriminatory hazard cost often have implications on foreign firms in a critical position as compared to domestic firms (Eden and Miller, 2004). Due to language differences, unfamiliarity of the host country's economics can affect the firm's operations as a whole.

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Previous literature has highlighted LOF as an exogenous variable, particularly on host locations vie (Barnard, 2010). However, the LOF impact differs from one host location to another depending on the ability of the firm itself. This shows that LOF is endogenous, when occurs interconnection between environmental based and firm specific factor into the internationalization process.

In a nutshell, LOF also appears from the firm-location interlinkage, which is crucial in the emerging market firm scenario (Luo and Tung, 2007; Ramamurti and Singh, 2009). For instance, the scenario of born global phenomenon contradicts the traditional view of LOF, whereby LOF’s impact will gradually disappear once firms get involved in internationalization. Further investigation in international business research, emerges – How does LOF impact the interaction between home and host country environment to the firms in foreign markets?

2 CONCEPTUAL UNDERSTANDING OF LIABILITY OF FOREIGNNESS (LoF) IN EMERGING MARKETS

The internationalization process involves the expansion of businesses into a new geographic region and this process also encourages domestic growth and value-creation of SMEs. The liability of foreignness (LoF) factor has a huge impact on the SME’s operation abroad. This scenario triggers the degree of differences between the home and host market to the SMEs internationalization. Hymer (1976) highlighted the importance of liability of foreignness along with SMEs establishment in abroad. Since 1960 empirical findings have shown that liability of foreignness (LOF) hinders international growth of SMEs (Hymer, 1960; Teagarden, 2015; Filatotchev, Knill, Reeb, & Senbet, 2017).

Foreign firms face additional costs that arises from the unfamiliarity with new environmental markets, which is considered as the 'liability of foreignness' (Zhang, Deephouse, Gorp, Ebbers, 2018; Zaheer (1995). Conceptually, the liability of foreignness appears when SMEs’ knowledge and capabilities are diminished and differences occur in the new market. However, new knowledge and capabilities is necessary for building a firm’s characteristics. These challenges occur when a firm first enters a new market that has differences in respect of political, economic, legal and cultural dimensions. Hence, due to these differences, firms need to adapt to these differences by changing their business strategies in favour of the local-context (Wei & Clegg, 2015; McDougall & Oviatt, 1996). Numerous scholars have investigated the significance of LOF in emerging markets (Jiang, Liu, & Stening, 2014; Wei & Clegg, 2015).

Zaheer (1995) had categorized four sources of costs that contribute to the liability of foreignness cost. There are costs that arise from transportation and coordination, due to firm's unfamiliarity with the local environment, arise from the host country environment due to the lack of legitimacy of the foreign firm and also occurrence from other countries economic nationalism, and arise from out of the home country environment (i.e. restrictions on high-technology exports, embargos on trade etc.).

Furthermore, Knack and Keefer (1997) also noted that emerging markets have their own unique environmental factors, which are cultural values. La Porta et al. (1997) found that countries with unique differences have strong normative professionalism and high levels of trust that facilitate economic activities, and at the same time disseminate the monitoring cost, thus, improving firm performance. The performance will be scattered across countries according to the firm’s stability and efficiency in cost management when doing business (Delios & Henisz, 2000; Henisz, 2000).

However, the liability of foreignness occurs when host country governments intervene by injecting investment to boost foreign direct investment. This will hinder competition between foreign and local firms as well as accessibility to local resources (Contractor, 2007). Instead, the host government should change the taxation structure, which is a business policy that will penalize foreign firms (Henisz, 2000). Conversely, local firms can urge the government act against foreign firms to stop the entry of foreign investors into the country (Henisz & Williamson, 1999). Consequently, instability of institutional government is a threat to foreign firms and can directly increase the liability of ownership in a host country.

From a holistic perspective, LOF is more pertinent to firms in developed markets and emerging markets. Technically, LOF involves two sources, namely, environmentally-derived LOF and firm-based LOF. Nachum (2003) and Zaheer (1995) had postulated that the external environment (government, institutions, industry and culture) in both the home and host country affects the LOF’s level of intensity that firms confront. LOF’s intensity also varies in regards to firm-specific characteristics, such as ownership, firm-specific resources, learning and network-based linkages (Johanson and Vahlne, 2009; Petersen and Pedersen, 2002).

Furthermore, the researcher argues that environmentally derived and firm-based LOF differ between emerging markets and developed markets. The Economist (2010) stated that government intervention in emerging markets often provides strong support to firms in these emerging markets as compared to firms in developed markets. For example, the Taiwanese government gave full support to their internationalization operations in the semiconductor industry and this resulted in the country’s current global leadership position in that industry (Tung, 2001). Such support has upgraded the industry’s networking and expanded sales to both emerging and developed markets. It has also helped Taiwanese firms’ brand image to overcome adverse country-of-origin effects, while the supporting systems have been able to diminish the magnitude of LOF that firms face. The next section will discuss LOF from a Malaysian perspective.

3 MALAYSIAN CONTEXT

Malaysia is transforming from an agriculture-based economy to a primary commodity-based economy. Due to the advancement of technology, an increase in knowledge-based and capital-intensive industries had helped Malaysia become the fastest export-driven economy. Instead, Malaysia offered high competition within other foreign investors to build their businesses involved in advanced technology-based manufactured products in international markets.

The Malaysian government has given pervasive support to help domestic enterprises to expand their businesses and further contribute towards Malaysia's economic development. Support in the form of licensing and permits, financial assistance, promotional activities and so forth, do nurture entrepreneurial skills among local SMEs. In addition, several government agencies, such as the Malaysian Entrepreneurship Development Centre, SME Corporation, Malaysian Industrial Development Authority (MIDA) and Multimedia Development Corporation (MDeC) also render support to local SMEs, (New Straits Time, June 10, 2009).

A key player in institutions, like the Economic Planning Unit (EPU), also plays a role in enhancing Malaysia's socio-economic development, encourage international competitiveness and utilize the abundance of local resources. The Malaysia External Trade Development Corporation (MATRADE) acts as the national trade promotion agency, actively involved in promoting local businesses to global clients. Numerous programmes have been organized by this agency to support Malaysian SMEs in accelerating in the global market (www.matrade.gov.my)

PEMUDAH (Pasukan Petugas Khas Pemudah Cara Perniagaan) is a special taskforce, which was initially formed to facilitate a better business environment amongst the public sector (www.pemudah.gov.my). This agency also helps to cultivate smooth business procedures for SMEs, such as 'easy-going' in government regulations, licensing matters, employing expatriates, and paying taxes. In respect of financial assistance, institutions such as Bank Negara, Bank Simpanan Nasional, Agrobank Malaysia, SME Bank, Credit Guarantee Corporation Malaysia Berhad and Export-Import Bank Malaysia Berhad (EXIM Bank) helps local SMEs to vigorously and proficiently expand their business.

The human resource development function, as in training, re-skilling employees, instilling entrepreneurial skills and short courses for managing businesses are also provided by several government agencies, such as the Centre for Instructors and Advanced Skills Training, the Japan-Malaysia Technical Institute (JMTI) and Advanced Technology Centres, MARA, German-Malaysian Institute, British Malaysian Institute and Malaysia France Institute.

Meanwhile, the Malaysian Intellectual Property Corporation (MIPC) helps local SMEs by providing assistance in managing the SME's intellectual property to ensure the businesses are protected by law. Additionally, implementation of the 9th Malaysia Plan (2006-2010) highlighted the development of local and global socio-economic platforms, which is part of the Malaysian government's development agenda. It basically focuses on boosting the Malaysia economy via high levels of productivity and stiffing the competitive environment. This action might encourage the private sector to get seriously involved in investments as one of the platforms for generating foreign investment. This will increase public-private partnerships, which will stimulate the development of small and medium enterprise (SMEs).

Integration of the government and other agencies will provide a tremendous opportunity for Malaysian SMEs, especially for expanding their businesses worldwide. In a nutshell, the government has expanded much effort to elevate local SMEs to the global market level. This strongly indicates that the liability of foreignness, in the Malaysian context, differs from other countries as it critically emphasizes on the government support system for reducing the implication of the liability of foreignness.

CONCLUSION

The previous section has shown that LOF is a mixture of exogenous (environmentally-derived) and endogenous (firm-specific) factors and there is a strong interaction of the two. Emerging markets and developed markets have distinct differences in regards to environmental conditions (institutions and industry) and firm-specific characteristics among LOF firms. These two interactions produce unique ways to influence LOF. Although previous studies have indicated that firms that venture into internationalization in emerging markets face a high level of LOF compared to developed markets, however, it still depends on the availability of specific industries, resource firm's position and the motive to venture into internationalization. Conversely, regarding practical contributions, managers involved in the internationalization process urge greater focus on the capitalization of environmental and firm-specific conditions in order to assuage the effects of LOF. For example, a manager should look comprehensively into industry conditions, motive internationalization ventures and the organizational structure rather than looking at differences in institutional development when dealing with a high level of LOF.

This study also postulated that not all firm's benefit from carrying out a business in a foreign country. It is not because of the ignorance of their presence in the foreign country but how they could overcome the fear of being a 'foreigner" by drawing their firm-specific capabilities. Future studies should investigate business environmental conditions, such as lower LOF conditions in emerging markets compared to developed markets. Thus, it can be concluded that LOF among firms abroad is determined by the interlinkage between environmental-specific factors and firm-specific factors.

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