THE INTERNATIONALIZATION PROCESSES IN SAUDI ARABIA: THE RELATIONSHIP BETWEEN INTERNATIONAL ENTRY MODE AND BUSINESS GROWTH IN SMES

MNAHEL S BABAGI

Jazan University, College of Business Administration

Abstract - The purpose of this research is to investigate how Saudi Small and Medium-sized Enterprises decide on their entry modes; what are the factors that influence such decision; and to what extent the business growth of these SMEs is affected by their entry mode.Considering the nature of this research which is Exploratory study, the quantitative approach will be developed. The survey will be the tool to collect the data from the business managers. The survey will be developed based on the theoretical framework (Figure 1) by reviewing the related literature. The survey will be validated by interviewing few academics who have an experience in international business area.

Keywords - Entry mode, SMEs, Business Growth

I. INTRODUCTION

In the current world economy, many corporation and organizations have opted to explore the foreign markets. The changes experienced in the market strategies have not only influenced the domestic market but also the international markets. The internationalization of developing country SMEs: the case of Saudi Arabia has its share of benefits including stimulation of employment and raising the wages. It stimulates the infrastructure development and the transfer of technology that suits the current organizations. Saudi Arabia is one of the most financial markets in the Middle East and therefore it is important to look into how SMEs have developed and entered the markets. The purpose of this research is to investigate how Saudi Small and Medium-sized Enterprisesdecide on their entry modes; what are the factors that influence such decision; and to what extent the business growth of these SMEs is affected by their entry mode.

II. LITERATURE REVIEW

2.1. Small and Medium-Sized Enterprises in Saudi Arabia

The Saudi Arabia possesses a wealthy economy based on oil and witnesses significant government control over the economic activities. It was given the 13 rank of being the most economically competitive country in 2010 and has been considered one of the ideal places to conduct business since 2004 (Ben Mansur, 2013). Saudi Arabia has also achieved much lower rankings and holds the 80th place for best countries for doing business according to Forbes (Forbes, 2016) Saudi Arabia is the largest producer and exporter of oil in the world. The cost of fuel in Saudi Arabia is second lowest in the country. Petroleum and petroleum products play an important part in the economy and contribute to 46% of GDP, 87% of budgeted revenues and 90% of earnings from exports (Ben Mansur, 2013) (Forbes, 2016) (Abdullah, et.aI. n.d). Saudi Arabia implements a free enterprise system and has strong business relationships with countries like USA, Japan, China and South Korea. Starting from 1973, the economy has opened up to foreign investments and business and a large number of joint ventures were established with the support of the government (Ali, 2009). It is the 25th largest export economy earning $182 billion in the year 2015 (OEC, n.d).

Small and Medium-Sized Enterprises in Saudi Arabia

As mentioned by Azyabi (2013) Western context is different to Saudi Arabia, which might result is different practices in many aspects. He stated that the contribution of Saudi SMEs to national GDP is limited compared to other countries. The following comparison, in Table 1.3, shows the contribution of the SME sector to some countries' GDPs. Saudi SMEs could contribute more to the Saudi GDP, if they can overcome the challenges they encounter. The researcher cannot find a formal definition for Saudi SMEs or up-to-date statistics. As a result, many agencies have provided different definitions for SMEs. The table presents the different definitions used by different institutions and researchers for SMEs in Saudi Arabia.

Institution/Researcher	Small-business	Medium-business
SMEs Development Centre at Eastern Province Chambers of Commerce	≤ 20 employees	>20 and ≤ 100 employees
Otsuki (2002)	≤ 60 employees	≥60 and <100 employees
Alasrag (2010)	≤ 20 employees	>20 and ≤ 100 employees
Al-Somali, Gholami, and Clegg (2011)	<25 employees	>25 and ≤ 100 employees
Saudi Industrial Development Fund	Sales less than SR 20 million*	
Alrajhi Bank	Sales less than SR 30 million*	
National Commercial Bank	Sales less than SR 30 million* + < 25 employees	

***SR: Saudi Riyal * Source Azyabi, 2013**

It can be concluded that the financial institutes define SMEs mainly based on their sales, while other agencies and researchers consider the number of employees. This research is using number of employees as a parameter for defining SMEs (small

organisations with ≤ 20 employees and medium organisations with >20 and ≤ 100 employees). All these circumstances of the Saudi context make it worthy to investigate its organization regarding their strategies for entering international markets.

2.2. International Entry Modes

A business firm can use various entry modes to gain entry to an international market. An entry mode may be described as the function the firm chooses to enter an international market (Brouthers, &Hennart, 2007). The most common methods of entry employed by firms include exporting, solo venture, joint venture and licensing. An entry mode should be chose with due consideration determining the costs and returns as it is not easy to change it afterwards (Agarwal, &Ramaswami, 1992). The exporting can be done through independent channels or directly by sending goods from the domestic country.

Foreign direct investments are also useful in gaining international market through techniques like acquisition and mergers or by establishing joint ventures (Rasheed, 2005). Traditionally the transactional cost was thought to be the most important factor when it came to selecting the entry mode. The cost involved in acquiring, negotiating and tracking the performance of promising international partners is obviously an important consideration. But currently the cultural context and organizational context variables also form a part of the decision. The cultural context helps gauge the potential risks of the specific market and work out the profit making opportunities. Usually firms will go for the entry mode which offers the maximum return on investment (Brouthers, 2013). The decision to choose a specific entry mode also depends on various risk factors of the new country where the firm is expanding. It includes the trading policies and the laws of the government which will impact the selection of the entry mode (Rasheed, 2005). Sometimes the initial entry mode can be modified to other forms of entry modes in the future. A firm may start with simple export operations and later after gaining experience in the foreign market it can develop complex organizational structures like joint ventures (Brouthers, &Hennart, 2007).

2.3. Factors for Selecting Entry Modes

There are several modes to enter the international markets. These foreign entry modes include indirect exports, direct exports, manufacturing subsidiaries, strategic alliances, licensing, contracting, sales subsidiaries, franchising, and joint ventures. The selection of right entry mode is very crucial for the success organization in international market (Ravelomanana, Yan, Mahazomanana&Miarisoa, 2015). There are lots of things which affect the choice of an organization to while selecting any entry mode. Some internal factors which influence this choice include company size, culture, relevant experience, managerial reasons, cost, relationships, flexibility, risks, and paybacks.

The size of the company is one of the most important factors in this regard because a company with strong and big human resources can manage expensive and compacted entry mode. Big size companies can go with direct investment modes. They can buy sales subsidiary or manufacturing subsidiary in various countries to launch their product. They can also build a strategic alliance with local companies to promote and distribute their products. On the other hand, small size companies can go with less expensive options like franchising, licensing and contracting. (Bridgman, 2016)

The cost of entry mode and financial situation of the organization has a strong impact on the choice of entry mode (Ahsan &Musteen, 2011). A financially strong company can afford to establish its own office or manufacturing unit in other countries. They can use multiple entry modes to make their international venture successful. Relevant experience is also important. If a company has international experience then it can analyze market more accurately. International experience helps the organization to minimize risks (Jain, 2015). An organization can hire experienced professionals before entering the international market. The absence of experience can lead to the selection of wrong entry mode which can lead to failure therefore relevant experience affects the choice of entry mode.

Organizational culture includes collective beliefs, values, and assumption of people in the organization. The culture of an organization also plays an important role because if an organization has diverse culture then it will be easy for the organization to select joint venture because they can blend with other organization efficiently (Petrou, 2009). If an organization has exclusive culture then it becomes difficult for such organization to use those modes which weaken its control. For instance, it becomes difficult for the organization to maintain its exclusive culture in its franchises and subsidiaries, therefore, organizations with exclusive culture opt for other modes to maintain its culture.

Managerial reasons include managerial strengths and preferences. Managers of the organization play vital role in selecting any entry mode (De Búrca, Brown & Fletcher, 2004). If managers are not comfortable with an entry mode due to any reason then they tend to oppose that entry mode. The relationship of organization with other firms and companies also influence the choice of entry mode. If a company has a strong relationship with local distributors then it can open its own office in the foreign region. Local distributors can help the organization to reach customers effectively

(Nalbandyan, 2017). If an organization has a weak relationship in the foreign market then it will have to select those entry modes which require less communication with other companies or it will have to build appropriate relationships before entering the foreign market.

The flexibility of the organization is another internal factor which influences the choice of entry mode. A flexible organization can go with options like contracting, strategic alliance and joint venture because they can handle change rather easily (Nisar, Boateng, Wu & Leung, 2012). If an organization has employees with flexible nature then it becomes easy for the organization to accept change. If an organization is not flexible then it can go with other options which require less change like franchising and subsidizing.

The choice of entry modes are not always driven by return on investments. There can be some restrictions or barriers which may force a firm to go for a specific type of entry mode. One crucial factor that comes to play in choice of entry modes is the resource availability of the organization. The financial and managerial capabilities of a company make up the resources that are used to carry out the operations in the intended international market. An organization may not have sufficient resources to introduce themselves in the country and hence go for entry points with lowest investment and risk factor which happens to be export. The aspect of risk can also persuade the firm to go for certain entry modes; the sole venture mode is a high risk mode while licensing is a low level one (Agarwal, 8. Ramaswami, 1992).

Another common barrier that forces the choice of entry modes on firms are the legal restrictions prevalent in the foreign country. Many governments restrict or forbid certain types of ownerships or business ventures and investments of foreign companies to favor the domestic industries. For example, some Central and Eastern European Countries limited foreign investment in joint ventures. Foreign companies also had to operate through domestically owned subsidiaries and were not allowed to wholly own them (Brouthers, &Brouthers, 2003). The prevalence of such laws put a limit on the firm's capabilities to exploit the new market or even gain entry to it. Here the entry mode cannot be judged based on transaction cost and the organizations have to rely on low integrated entry modes. Such laws can make the firm to go for joint venture mode while the absence of such laws makes a firm prefer a wholly owned venture in the foreign country (Brouthers, 2013).

2.4. Business Growth

Growth in business is perceived as a sign of progress and success and desired by all business owners. Business growth is a phase when the firm gains the grounds for expansion and looks for additional means to create more profit. Business growth is a result of the business lifecycle, the industry growth patterns and the business's want to create equity value (Inc, n.d.).

A firm can use various ways to measure its growth by choosing different growth indicators. One common indicator used to measure growth is turnover or sales. The data can be easily obtained and the process of determining growth is also easy. The employment generation capacity of the firm is also another popular objective measurement of growth. The market share of the company can also be used to determine growth. Manufacturing companies can use the change in assets as way to measure their growth, but it should not be used for other industries because it can qualify as inflation. Some studies use subjective growth indicators like satisfaction but it is discouraged because it solely depends on the personal expectations and the knowledge of the business owner. It also has to be considered that using different growth indicators may produce different outlook on the growth of the organization (Davidsson, et. al. 2006)

III. RESEARCH OBJECTIVES AND QUESTIONS

The objective of this research is to look into internationalization issues of Saudis SMEs as a case of developing country. This will be achieved through assessment of the relevance of the business relationships and the role of stakeholders. Furthermore, the consideration of the globalization impact and the nature of internalization will be discussed in the developing country context. For this purpose, an analysis of the internalization process in the developing country is effective.

The development and growth of knowledge transfer in the international context and in the case the internationalization focuses on the implementation of international business knowledge. In the light of research objectives mentioned above, the proposed research questions are:

- What are the international entry mode that Saudi SMEs are adopting the most in their internationalization processes?
- What are the factors that influence the Saudi SMEs choices in regards to entry mode?
- To what extent that the entry mode is related to the Business growth of the Saudi SMEs?

Such research will contribute to the body of knowledge by exploring how Saudi SMEs are strategically selecting their international entry mode and what are the factors (internally and externally) that affect such selection. This contribution is represented through developing and empirically testing a framework that can:

- Help in understanding Saudi SMEs in terms of choosing the entry mode;
- Explain the relationship between internal and external factors and entry mode; and
- Elucidate the relationship between entry mode and business growth

In terms of practical contribution, this research contributes to the Saudi Arabian context where there is a significant paucity of research in general and in the international business in particular.

IV. RESEARCH METHOD

Considering the nature of this research which is Exploratory study, the quantitative approach will be developed. The survey will be the tool to collect the data from the business managers. The survey will be developed based on the theoretical framework (Figure 1)by reviewing the related literature. The survey will be validated by interviewing few academics who have an experience in international business area.

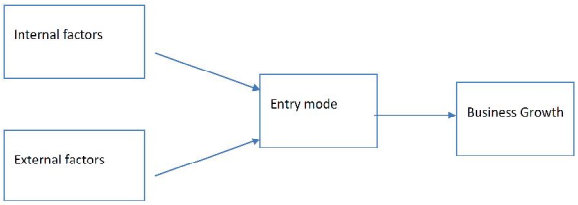


Figure 1

If there is a need for explanation on the result, the researcher might conduct some interviews with mangers Saudi SMEs to get in depth understanding for their motivations in selecting the entry mode. In such case the research will be following a mixed methods approach instead of pure quantitative approach.

In more details, the philosophical perspective, research methods and the data collection techniques are all summarized as follows:

Philosophical Paradigm	Positivism
Research Purpose	Exploratory
Form of Research questions	What, to what extent
Research method	Quantitative
Data collection method	Survey
Unit of analysis	Firm

V. DATA COLLECTION

The collection of data in this research will be done through the primary and secondary data extracted from a survey. The primary data that is collected in the initial stages of the survey will give us the comprehension of the research topic. In case there is the inability to obtain enough data, then we will resolve to focus on the secondary data. The secondary data will be extracted from surveys that have already been collected by other people. This will not only be time efficient but also precise in the research (Teagarden et al., 2009). Additionally, the research will depend on both the independent variables and the dependent variables in the correction of the data relating to history and evaluation of the cooperation between organizations.

The Saudi chambers of commerce in Jazan, Jeddah, Riyadh and Dammam have the contact details of the registered Saudi SMEs. The researcher will contact the SMEs through chambers of commerce, who will send the online survey to the registered SMEs.

VI. DATA ANALYSIS

The data analysis that is aimed at testing the described theory will be based on a simple regression analysis that will be done to establish a relationship between the market and the existence of the SMEs. Besides, simple regression analysis will also be applied to develop the partnership between the small scale industry and the stakeholders in the partnership. The excepted outcomes of the research are that in case there is a relationship between the primary stakeholders, and then there would be evidence that means that the partnership between the companies was aimed at attracting more customers and broadening the market.

Based on the results of the study, the assumption is that the internationalization of developing country SMEs: the case of Saudi Arabia will be successful since Saudi Arabia has attractive business opportunities for investors. Future research on the topic should focus on the potential of Saudi Arabia as a developing country and the investment decisions.

REFERENCES

[1] Abdullah, A. B. M., Saeed, M., Ondracek, J. Bertsch, A. International Business Landscape of Saudi Arabia and Dubai: A Comparative Study of Two Energy—Based Economies.

[2] Agarwal, S., Ramaswami, S. N. (1992). Choice of foreign market entry mode: Impact of ownership, location and internalization factors. Journal of International business studies, 1-27.

[3] Ahsan, M., &Musteen, M. (2011). Multinational enterprises' Entry Mode Strategies and Uncertainty: A Review and Extension. International Journal of Management Reviews, 13(4), 376-392. http://dx.doi.org/10.1111/j.1468-2370.2010.00296.x

[4] Ali, A. (2009). Business and management environment in Saudi Arabia: challenges and opportunities for multinational corporations. Routledge.

[5] Azyabi, N (2013). Knowledge Management Strategic Orientation is SMEs. Monash University, PhD thesis

[6] Ben Mansur, A. M. (2013). How trust factors affect business relationships in Saudi-Arabian companies (Doctoral dissertation, University of Salford).

[7] Bridgman, B. (2016). Market Entry Mode: Evidence from the Golden Age of Hollywood. Economic Inquiry, 55(2), 778-793. http://dx.doi.org/10.1111/ecin.12397

[8] Brouthers, K. D. (2013). Institutional, cultural and transaction cost influences on entry mode choice and performance. Journal of international business studies, 44(1), 1-13.

[9] Brouthers, K. D., &Brouthers, L. E. (2003). Why service and manufacturing entry mode choices differ: The influence of transaction cost factors, risk and trust. Journal of management studies, 40(5), 1179-1204.

[10] Brouthers, K. D., &Hennart, J. F. (2007). Boundaries of the firm: Insights from international entry mode research. Journal of management, 33(3), 395-425.

[11] Davidsson, P., Delmar, F., &Wiklund, J. (2006). Entrepreneurship and the Growth of Firms. Edward Elgar Publishing.

[12] De Búrca, S., Brown, L. and Fletcher, R. (2004) International Marketing: An SME Perspective. 1st Edition, Financial Times Prentice Hall, Harlow,

[13] Forbes. (2016) Best Countries for Business: Saudi Arabia- https://www.forbes.com/places/saudi-arabial

[14] Inc. n.d. Organizational Growth. https://www.inc.com/encyclopedia/organizational—growth.htmI

[15] Jain, N. (2015). Financing and Mode of Entry in Foreign Markets. SSRN Electronic Journal. http://dx.doi.org/10.2139/ssrn.2583051

[16] Nalbandyan, H. (2017). SMEs Entry Mode Choice into Foreign Markets. Business Strategies, (1), 55-59. http://dx.doi.org/10.17747/2311-7184-2017-1-55-59

[17] Nisar, S., Boateng, A., Wu, J., & Leung, M. (2012). Understanding the motives for SMEs entry choice of international entry mode. Marketing Intelligence & Planning, 30(7), 717-739. http://dx.doi.org/10.1108/02634501211273823

[18] OEC. (n.d) Saudi Arabia. http://atlas.media.mit.edulenlprofilelcountrylsaul

[19] Petrou, A. (2009). Foreign Market Entry Strategies in Retail Banking: Choosing an Entry Mode in a Landscape of Constraints. Long Range Planning, 42(5-6), 614-632. http://dx.doi.org/10.1016/j.lrp.2009.09.001

[20] Rasheed, H. S. (2005). Foreign entry mode and performance: The moderating effects of environment. Journal of Small Business Management, 43(1), 41-54.

[21] Ravelomanana, F., Yan, L., Mahazomanana, C., &Miarisoa, L. (2015). The External and Internal Factors That Influence the Choice of Foreign Entry Modes at Wuhan Iron and Steel Corporation. Open Journal of Business and Management, 03(01), 20-29. http://dx.doi.org/10.4236/ojbm.2015.31003

[22] Teagarden, M. B., Pashtenko, V. H., Ahmed, Z. U., Abdul, R. C., Nor, H. A., Mohd, Z. A., …Academy for Global Business Advancement. (2009). Advances in global business research. Rockwall, TX: Academy for Global Business Advancement.

★★★