

# HOME COUNTRY INSTITUTIONAL CONTEXT AND FIRMS' INTERNATIONAL PERFORMANCE: A STUDY OF SMES IN MALAYSIA

Tze Cheng Chew

Labuan Faculty of International Finance, Universiti Malaysia Sabah Labuan International Campus,  
Jalan Sungai Pagar 87000 Labuan F.T

For correspondence; Tel. + (60) 87465232, E-mail: [chewtzecheng@ums.edu.my](mailto:chewtzecheng@ums.edu.my)

**ABSTRACT:** Previous research has mainly focused on the impact of host country institutional context on foreign entrants and yet with the rise of outward internationalization of firms from emerging and developing economies, the empirical findings are relatively scant. Drawing from the institutional perspective, this study intends to examine the home country's institutional context for encouraging international business activities and performance. Specifically, the study proposes that a supportive home country institutional context will lead to greater outward internationalization and performance of local firms. These predictions are tested on a sample of 203 international SMEs located in Malaysia. The analysis shows that a supportive home country institutional context in terms of regulatory, normative and cognitive dimensional affects significantly on SMEs' international performance. Significant practical implications are derived accordingly for business practitioners and policymakers to promote SMEs' international business development and growth.

**Keywords:** SMEs; Institutions; Institutional Perspective; International Performance; Malaysia

## 1. INTRODUCTION

The drivers of firm performance have been studied extensively in the international business literature. In an attempt to complement the resource-based view and conceptualize how the context affects firm performance, extant research has recently focused on institutions [1].

Institutions are characterized by regulative, normative and cognitive dimensions that shape firm behavior and performance [2, 3].

Previous studies have generally focused on the impact of the host country's institutional context in attracting and supporting inward internationalization. This is given because typical foreign entrants studied are multinational enterprises from developed economies that host countries are trying to attract to do business in their countries. As a result, the pro-outward internationalization policies adopted by home country governments in assisting and promoting domestic firms have arguably been neglected [4, 5].

With significant outward internationalization especially by small-and-medium enterprises (SMEs) from emerging and developing economies, it is essential to examine the home country's institutional context which exerts an influence on firms' multiple facets of internationalization behaviour and performance [5, 6]. Recent works also emphasized on the theoretical value of studying firms from emerging and developing countries which its' institutional conditions for business transactions are less developed and established compared to developed countries [7].

Although research often presumes that a more developed and supportive institutional environment has a positive association with firm performance; findings of the relationship are inconclusive [8, 9]. While some studies provide evidence of a positive association, there are studies that find the two constructs to have weak or no significant relationships [10].

In response, it is the objective of this study to examine the effects of the home country's institutional context on the internationalization of firms from developing countries. More specifically, the objectives of the study are to assess the perceived levels of the home country institutional context in

Malaysia and to examine the association between a supportive home country institutional context and international performance of Malaysian SMEs.

## 2. LITERATURE REVIEW

The theoretical foundation underpinning this research is couched in the institutional perspective, which suggests that the success and failure of firms are enabled and constrained by external factors, i.e. institutional contexts [2-4]. More specifically, it is about how the behaviour and performance of a firm are shaped and conditioned by the institutional context in which it operates.

### *Perceived level of home country institutional context*

The host country institutional context has received a great deal of attention in the international business literature [11, 12].

However, researchers have acknowledged that institutions adopted by the home country cannot be ignored in order to grasp a better understanding of the internationalization of firms, particularly firms from emerging and developing countries [5, 12].

Differences in the home country institutions' support for internationalization may induce different behaviours of international SMEs' activities across countries. The role of the home country's institutional context in constructing and maintaining an environment supportive to international business activities is widely acknowledged in the literature [13]. The level of international business activities that develop in a society is directly related to the quality of its' home country's institutional context [4, 5, 11]. That is, the institutional context could either present a set of opportunities, or threats that subsequently enable or constraint the internationalization activities of firms [11]. In the extant literature, there are two prominent views that argue the role played by the home country's institutional context behind outward internationalization.

First, the "fostering view" which argues that the institutional context is viewed as a positive mechanism or enabling force when it promotes and facilitates firms' outward internationalization [13, 14]. That is, firms may utilize its' home country's institutional context as a positive factor

behind their internationalization. For example, a high level of institutional support in terms of getting access to subsidies may assist firms to compete effectively in international markets [15]. Next, the "escape view" which argues that the institutional context is viewed as a constraining force when it constraints firms and the firms eventually have to escape from its' own burdensome home country institutional context to seek for better opportunities in host countries [14,16,17].

Thus, the study attempts to assess whether international SMEs in Malaysia perceive home country institutional context as enabling or constraining forces towards their international activities and performance. Next, the study develops a conceptual model between a supportive home country's institutional context and firms' international performance.

#### ***Home country institutional context and firms' international performance***

Smaller firm size is often seen as an indication of fewer resources. In this regard, SMEs are believed to have inherent resource limitations (e.g. financial capital, human capital, knowledge, and information, etc.) and therefore their development is often hampered [18]. The liabilities of small firms have increased particularly with internationalization, due to the liabilities of foreignness in doing business in unknown environments. Therefore, it is often presumed that the inherent resource limitations of SMEs will hinder their pursuit of internationalization [19]. However, with a supportive home country institutional context, it can reduce the inherent resource limitations and the liabilities of foreignness faced by SMEs.

Based on Scott's (1995) conceptualization of institutional dimensions, Kostova (1997) introduced a three-dimensional institutional country profile, regulatory, normative and cognitive dimensions that will affect international business activity. The regulatory dimension refers to laws, regulations, and written rules that promote or restrict certain behaviours [2]. In the context of promoting outward internationalization, this dimension entails laws, regulations, and governmental policies that support international SMEs and facilitate the efforts to acquire resources to sustain internationalization [20]. Past studies show that supportive government regulations that provide financial and non-financial resources to international business activities may help ease the limitations of SMEs and support them to implement effective international business strategies [21].

The normative dimension reflects general social norms, values, beliefs, and assumptions about the ways humans should behave in a given society [2]. In the domain of international business, this dimension captures the degree to which a country's residents value on international business activities [3, 20]. In the context of promoting outward internationalization, the value system in a country that acknowledges and appreciates the success of an international business will influence the firms' perception of the economic and desirability of international business actions; these perceptions, in turn, will determine actions undertaken. That is, more firms will venture into international business.

The cognitive dimension captures cognitive structures, such

as heuristics, mental models, social knowledge, and behavioural patterns shared by members of a given country [2]. In the specific domain of international business, this dimension extends to the company's skills and knowledge related to doing business internationally [3, 20]. As practices and knowledge become institutionalized, information becomes part of the shared social knowledge [22]. In the context of promoting outward internationalization, knowledge about international business procedures and processes are disseminated among firms and firms know where to get information related to international business.

Therefore, in view of the importance of a supportive home country institutional context to the international performance of the firms based on the aforementioned discussion, the following hypothesis is proposed:

*H1: A supportive home country's institutional context is positively associated with the international performance of the firms.*

### **3. RESEARCH METHODOLOGY**

#### ***Research context***

Data was collected in Malaysia, one of the rising economies in the world. Malaysia is an ideal context for exploring the research objectives due to its' strategic location within the South East Asian region. Malaysia is known as one of the four "Tiger Cub Economies" of the South East Asian region due to its rapid financial liberalization, stock market growth and ongoing economic development [23]. Furthermore, international business has always been important for the Malaysian economy as the country has enjoyed twenty consecutive years of trade surplus since 1998 [24]. This remarkable performance has demonstrated the competitiveness of Malaysian firms in international markets. Hence, the country provides an intriguing empirical context for researching the topic.

#### ***Measures***

A self-administered survey was distributed among international SMEs in Malaysia based on a list obtained from Malaysia SME Corporation. In total, 203 completed usable questionnaires were obtained and used for analysis, giving a response rate of 20.3 percent. In order to obtain valid and reliable measures of the variables, previously validated scales were used for all the constructs in this study. The study used a total of thirteen items to capture the three reflective dimensions of the country's institutional profile for international business: five items for regulatory dimension, four items for cognitive dimension and four items for the normative dimension by Descotes et al., (2011). As for international performance, the study employed subjective indicators in which key respondents were asked to assess the performance of their firms in the international marketplace in terms of sales level, growth, profitability, and overall performance in foreign business activities. This approach follows previous studies, which has reported adequate reliability estimates for very similar scales of performance [25]. All ratings used a 7-point Likert scale. Firm age; firm size in terms of a number of employees; industry; and international experience of the firm were included as control variables.

#### 4. RESULTS

##### *Perceived level of home country institutional context*

The level of home country institutional context among international SMEs in Malaysia is perceived to be high. The overall mean is 4.78 (Table 1). Among the measures of home country institutional context, the normative dimension (5.98) is perceived to be relatively higher than the other two dimensions; regulatory (4.02) and cognitive (4.35). Based on the results, Malaysia's institutional context can be considered as a supportive and international business-friendly environment towards its' own domestic firms.

**Table 1: Mean for Home Country Institutional Context**

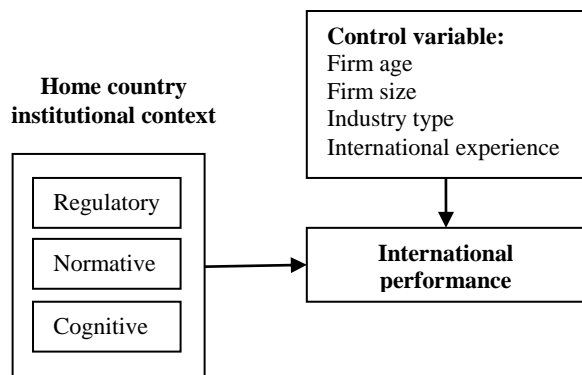
Construct	Dimension	Mean	Standard Deviation
Home country institutional context	Regulatory	4.02	1.03
	Normative	5.98	0.86
	Cognitive	4.35	0.98
	Overall mean	4.78	

Note: The items for the construct were assessed using 7-point Likert scales.

##### *Association between a supportive home country institutional context and firms' international performance*

The study used the partial least squares (PLS) regression to analyze the data and evaluate the relationships between the two constructs; home country institutional context and international performance in this study (Figure 1).

PLS requires neither a large sample nor normally distributed data. It also has the ability to account for measurement errors



of multiple latent constructs and to examine the significance

**Figure 1 Conceptual Model of the Study**

of structural model simultaneously [26]. To interpret and analyze the proposed model using PLS, the analysis went through two distinct stages; (1) evaluation of the measurement model and (2) analysis of the structural model. This sequence ensures that the proposed measurement scales are valid and reliable before testing the hypotheses [26].

##### *Analysis of the measurement model*

The measurement model in PLS was assessed by examining: i) individual item reliability (factor loadings); ii) internal consistency reliability (Cronbach's alpha and composite reliability, CR); iii) convergent validity (average variance

extracted, AVE); and iv) discriminant validity. The results are presented in Table 2 and Table 3. Individual reflective item reliability is considered adequate when an item has a factor loading that is greater than 0.70 on its respective construct [27].

Both CR and AVE values also exceeded the recommended values of 0.70 and 0.50, respectively [28]. Thus, the results support the convergent validity of the constructs considered in this study. Finally, discriminant validity is to assess the extent to which measures of one construct differ from the measures of another construct [26]. The Fornell-Larcker criterion approach is generally used to assess the discriminant validity of the measurement model [26]. It compares the square root of AVE of each construct, which should be greater than the variance shared between the construct and other constructs in the model (the squared correlation between the two constructs) [28]. For adequate discriminant validity, the diagonal elements should be significantly greater than the off-diagonal elements in the corresponding rows and columns.

**Table 2: The Measurement Model: Factor loadings, Cronbach's Alpha, CR and AVE**

Construct	Item	Factor loading	Cronbach's alpha	CR	AVE
Home country institutional context (HCIC)	REG1	0.823	0.848	0.889	0.790
	REG2	0.870			
	REG3	0.708			
	REG4	0.770			
	REG5	0.802			
	NOR1	0.873			
	NOR2	0.904			
	NOR3	0.852			
	NOR4	0.831			
	COG1	0.749			
	COG2	0.828			
	COG3	0.779			
International performance (IP)	COG4	0.797	0.921	0.943	0.806
	IP1	0.928			
	IP2	0.929			
	IP3	0.792			
	IP4	0.933			

##### *Analysis of the structural model*

Once the construct measures are confirmed as reliable and valid, the next step in PLS is to assess the structural model. This involves examining the model's predictive capabilities and the relationships between constructs [26]. Statistical results of the model's predictive capabilities ( $R^2 = 0.290$ ) and the relationships between the constructs using the bootstrap method indicate a significant direct positive association ( $\beta=0.358$ ,  $T=3.569$ ,  $p>0.001$ ) between home country institutional context and firms' international performance (Table 4). Hence, Hypothesis 1, which predicted that a supportive home country's institutional context would be positively associated with the international performance of the firms, is fully supported. The findings provide empirical support that a supportive home country's institutional context towards international business positively influences the international performance of SMEs in terms of foreign

business sales, growth, profitability and the overall performance in foreign business activities.

**Table 3: Fornell-Larcker Criterion Analysis for Checking Discriminant Validity**

	HCIC	IP
HCIC	<b>0.889</b>	
IP	0.509	<b>0.897</b>

Note: Numbers in bold indicate the square root of the AVE for each construct.

**Table 4: Path Coefficient and T-values for the Structural Model**

Structural path	Path Coefficient	T-values	Results
HCIC → IP	0.358	3.569***	Hypothesis supported. There is a positive association between HCIC and IP. High levels of HCIC associated with higher levels of IP.

Note: \*\*\*p < 0.001

## 5. CONCLUSIONS

The study develops an institution-based theoretical framework to explain the outward internationalization of firms from a developing country context. The study contributes to the literature by enriching empirical evidence of the positive impact of a supportive home country's institutional context on firms' international performance. First, the findings show that a supportive home country institutional context could actually encourage firms' outward internationalization. These findings support Young et al.'s [29] argument that the lack of institutional support may pose a threat to firms' competitive advantage. Overall, the findings are more consistent with the view that home country context as enabling forces towards firms' performance.

Second, the majority of extant research on home country institutional context and its effects on firms' international performance has mainly concentrated on certain countries, particularly developed countries in North America and Europe which its' institutional conditions for business transactions are well established [7]. Hence, the findings of the study which derived from a developing country context, i.e. Malaysia supplement prior studies and also reflect similar findings for studies that were mostly undertaken in those aforementioned developed countries. The findings provide important contextual implications for Malaysia as well as other developing countries in general and specifically the Tiger Cub Economies (e.g. Philippines, Indonesia, and Vietnam) in the same region. This is important because many of these countries and their firms are increasingly active and are becoming important international markets [6]. The study also carries important implications for policy-makers. The findings encourage emerging and developing countries to build institutional capacity that will assist in fostering the outward internationalization of firms.

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