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***International Journal of Multinational Corporation Strategy 2016, 1(3/4), 247-268.***

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**DOI link to article:**

<https://doi.org/10.1504/IJMCS.2016.10002103>

**Date deposited:**

27/04/2017

**Embargo release date:**

23 June 2017

# **Internationalization Process of Chinese SMEs: The Role of Business and Ethnic-Group based Social Networks**

## **Abstract**

This article examines how emerging market small and medium-sized enterprises (EM-SMEs) leverage their social network relationships for their internationalization process. Drawing from the internationalization process and network literature, it investigates four Chinese SMEs which have effectively entered foreign markets. The sample of Chinese manufacturing SMEs provides a valuable reference to compare and contrast the challenges and opportunities that foreign-network-constrained SMEs face in their internationalization process. Our case study highlights the importance of both business and ethnic group-based social ties and the strength of these networks which help the internationalization of Chinese SMEs. Particularly, the findings illustrate the importance and complementary role of ethnic ties (i.e., social networks) and relationships with multinationals (i.e., business networks) that enable the internationalization process of the EM-SMEs.

**Keywords:** emerging market SMEs, internationalization process, social network, ethnic ties, China

## **Introduction**

This article investigates the internationalization process of Chinese small and medium-sized enterprises (SMEs) by comparing and contrasting the challenges and opportunities that those SMEs faced in their foreign-market entry. Extant research on this topic have utilized the internationalization process (Johanson and Wiedersheim-Paul, 1975; Johanson and Vahlne, 1977), and international new ventures (Oviatt and McDougall, 1994, 1995; Knight and Cavusgil, 2004; Sui and Baum, 2014) approaches to explain relatively young entrepreneurial firms' behaviors in various international contexts. Recent internationalization studies have begun to adopt a network perspective to explain the internationalization process (Zhou, Wu, and Luo, 2007; Johanson and Vahlne, 2009; Sandberg, 2014; Phino and Prange, 2016). A network indicates business, social, political, and technological relations with other firms and institutional agencies (Larson and Starr, 1993; Johanson and Mattsson, 1988; Vasilchenko, 2011; La Rocca et al., 2013; Zhang et al., 2016).

These studies have greatly enhanced our understanding about how SMEs internationalize. However, some questions still remain under examined. For instance, we do not know much about the relative importance of different types of network ties and the strength of them for emerging market SMEs (EM-SMEs)' internationalization. Recently, Prashantham et al.'s (2015) Indian SME study stresses whether formal networks with multinational enterprises (MNEs) or informal social ones facilitate the internationalization of EM-SMEs remains under examined. Inspired by a line of network-based SME literature (e.g., Blazquez-Lidoy et al., 2006; Lee et al., 2001; Pinho and Prange, 2016; Prashantham et al., 2015), we investigate the roles of both business and social network ties in facilitating the EM-SMEs' internationalization. Typically, EM-SMEs face not only a liability of newness, but also lack key resources for internationalization (Tang, 2011). Particularly, we are interested in ethnic ties among social networks in that network and resource-scarce EM-SMEs may engaged in internationalization by leveraging their ethnic networks in foreign markets (Prashantham and Dhanaraj, 2010, 2015; Jean et al., 2011). Jean et al. (2011) found that ethnic ties

were important for Taiwanese-based business groups foreign direct investment location choice. However, we have an insufficient understanding about the overall interaction process that take place between the SMEs and the associated network actors in influencing the internationalization process of such firms (Araujo et al., 2003; Sandberg, 2014). This gap is even glaring in the context of EM-SMEs (e.g. Tang, 2011; Zhang et al., 2016).

In this article, business networks refer to the firm's formal relationships with its business partners for business opportunity exploitation (Johanson and Mattsson, 1988; Lew et al., 2013); and social networks indicate their informal relationships based on the focal firm's cultural backgrounds and societal norms which are beneficial for the firm's opportunity recognition (Vasilchenko, 2011; Prashantham and Dhanaraj, 2010; Jean et al., 2011). In the SMEs context, *'internationalization is seen as an entrepreneurial process embedded in an institutional and social web which supports the firm in terms of access to information, human capital, finance, and so on'* (Bell et al., 2003, p.341). Arguably different types of network relationships and the relative strength of ties originating from heterogeneous business and social networks would influence these firms internationalization process differently (Ellis, 2000; Sandberg, 2014; Zhang et al., 2016). Thus, internationalizing SMEs are able to strengthen their network positions in the foreign market through the relationship commitment to business networks, learning, and social ties with these networks (Johanson and Vahlne, 2009). However, majority of SMEs' internationalization studies focus on the developed country SMEs and their entrepreneurial orientation (Harms and Schiele, 2012; Jones et al, 2011). Existing literature has not sufficiently investigated EM-SMEs' internationalization process from various network angles, including the business and social networks (Blazquez-Lidoy et al., 2006; Prashantham et al., 2015). Above all, the role of ethnic ties in influencing the EM-SMEs internationalization process has been under examined by the wider strategy and international business literature (Zaheer et al., 2009; Prashantham and Dhanaraj, 2010, 2015).

To address the above gaps, this article asks the following two inter-related questions: *how the relative strength of ties of business and ethnic-group based social networks of Chinese SMEs affect such firms' internationalization process? How do they leverage their social capital for international success?* This research advances the existing EM-SMEs and the internationalization process literature in three important ways. First, this article demonstrates the relative value and strength of both formal business networks in host markets as well as informal ethnic-group based social networks in influencing emerging market SMEs' internationalization process. Second, it complements the traditional internationalization process literature by showing that risk taking behaviors of Chinese SMEs when it comes to their internationalization being overcome by utilizing diverse types of networks relationships. Lastly, it is one of the very few studies that examines both the *business* (thus economic and formal) and *social* (thus relational and informal) ethnic network ties on emerging market SMEs' internationalization in the context of the largest emerging economy of China (e.g., Tang, 2011; Zhang et al., 2012, 2016; Zhou et al., 2007).

## **Conceptual Background**

### **Internationalization Process Theory**

In 1970s, the internationalization process theory known as a stage model of firm internationalization provided a groundbreaking opportunity for international business research (Johanson and Wiedersheim-Paul, 1975; Johanson and Valhne, 1977). The theory argues that the firm gradually internationalizes to overcome liabilities of foreignness while learning about market knowledge through incremental international experiences (Johanson and Valhne, 1977). Thus, such firm gradually commits resources to foreign markets to avoid risks in them. In other words, internationalization of the firm can be seen as a gradual process of incremental learning and gaining experience of foreign markets. In a nutshell, the theory explains the internationalization process of logical incrementalism (Sullivan, 1994; Lew et al., 2013).

More specifically, Johanson and Vahlne (1977) proposed the Uppsala Internationalization Model: the market understanding and resource commitment of companies (i.e., state aspects) affect commitment choices and existing business doings (i.e., change aspects). The change feature in turn augments the market familiarity and induces further resource commitments by firms in their chosen foreign markets in the next phase. Thus, this model explains that the internationalizing firm steadily increases its global activities within the foreign markets. The international market commitment in the Uppsala model is affected by two factors, i.e., the amount of resources invested and the level of involvement in foreign markets. Through this, knowledge accumulates in the firm boundary, and learning and commitment building are imperative mechanisms for internationalization and overcoming psychic distance albeit these take time. This resonates with risk-avoiding behavior of the firm rather than risk-taking, which influences the firm's internationalization strategies including the entry mode and foreign market selection.

Management scholars distinguish knowledge into two main types, i.e., objective knowledge and experiential knowledge (Eriksson et al., 1997; Hilmersson, 2014). The former can be easily codified, thus easily transferred abroad and exploited by firms' competitors. However, the latter is region or country-related and potentially hard to codify and imitate, thereby the key motivation of internationalization of the firm. In the internationalization process, successful firms thrive in accumulating the latter type of knowledge which helps in establishing foothold in a foreign market. Once the firm learns about the host country, it can decide the entry-strategy including the entry mode and select the appropriate market to enter. As such the Uppsala model underlines the significance of experiential knowledge for internationalization, indicating that such knowledge is difficult to learn compared to objective knowledge. This experiential understanding induces business opportunities for the firm and facilitates its internationalization activities (Johanson and Vahlne, 1977), thus gaining experience and knowledge about a foreign market are important factors during the internationalization process of the firm. The internationalization activities also allow the firm to complement the knowledge voids within the firm's boundary, and this happens through

experiential learning as the newly encountered experiences are compared to preceding experiences (Jones and Casulli, 2013). The emergent experience in international activities encourages management to take a renewed look at international opportunities which help make a better strategic decision-making about which markets to enter and how to enter.

As discussed above, the key notions of the internationalization process are knowledge and experience. This stream of literature emphasizes that gradual internationalization process is due to a lack of knowledge about the foreign market. In addition, the process depicts an incremental commitment to a foreign market of which each stage is innovative, thus internationalization is associated with innovation (Bilkey and Tesar, 1977; Cavusgil, 1980). Based on this, it can be argued that the firm's internationalization process is driven by innovation (Knight and Cavusgil, 2004; Onetti et al., 2012). However, firms' internationalization processes are different in various contexts and the demarcation criteria for such internationalization stages vary (Miesenbock, 1988; Andersen, 1993; Tang, 2011; Zhang et al., 2012). The foreign expansion strategy itself is risky and internationalizing firms can overcome these risks through accumulated experiences and forming business networks with other firms in the foreign market (Ellis, 2000; Tang, 2011; Sandberg, 2014). For this reason, based on the previous internationalization process model, Johanson and Vahlne (2009) revised it by taking a network perspective to understand firms' internationalization process. The updated model illustrates that internationalizing firms largely benefit from investing in their foreign business networks. If the firm has a position in such networks, it can have an opportunity for strengthening its network position by developing social capital. Through exploiting such networks in foreign markets, the firm can establish cohesive relationships with networks of business partners and further get access to the market knowledge. The above discussions show the importance of having the network perspective on the firm's internationalization process.

## **Networks in the Internationalization Process**

A key assumption of the network-based approach to the analysis on internationalization process is that the firm interacts with other economic and social actors overseas in the process of continuous internationalization and accumulative learning (Chandra et al., 2009; Johanson and Mattsson, 1988; Kontinen & Ojala, 2011; Sharma & Blomstermo, 2003). For instance, Chandra et al. (2009) found that business contacts have a significant impact on discovering the opportunity in foreign markets. The firm's success in entering new markets and operations overseas lies on how it effectively builds up networks. Thus, networks matter regarding the internationalization process of SMEs.

Aforementioned, Johanson and Vahlne's (2009) *business network theory* revised the earlier internationalization process model emphasizes the internationalization process from the network angle with diverse and complex patterns. The *business networks* not only cover the different types of relationships and their roles, but also different factors such as trust, control, resources, and interdependency within the firm and between firms. It is pertinent for firms to cultivate relationship to penetrate such networks in foreign markets because these relationships also offer opportunities for learning about new knowledge such as technologies, markets and consumers for competitive advantage (Yli-Renko et al., 2002; Lew et al., 2013). Furthermore from a position perspective, developing relational capital such as trust and commitment in the *social networks* is critical (Chetty and Agndal, 2007; Prashantham and Dhanaraj, 2010), as internationalizing firms need to establish their network positions in such foreign networks (Oviatt and McDougall, 1994; Hilmersson and Jansson, 2012; Sandberg, 2014; Pinho and Prange, 2016).

The opportunity recognition and exploitation differs across different types of networks. For instance, Vasilchenko and Morrish's (2011) study of firms in information and communication technology sector suggested that social ties are beneficial for corporate opportunity recognition, and on the other hand, business ties help in opportunity exploitation. The social ties provide rich and reliable information capital for entrepreneurs as well as big multinationals which are helpful to opportunity recognition (Ellis, 2000; Meyer, Mudambi, and Narula, 2011). For instance, Kontinen



and Ojala (2011, p.441) state, '*internationalization is related to the development of network ties with other firms belonging to a network in a foreign market. These ties between firms in different markets act as bridges facilitating foreign market entry*'. Thus the internationalizing SMEs can also get market and technical know-how through business ties by connecting with key business partners (Tang, 2011; Sandberg, 2014). At the same time, business ties can help SMEs overcome resource constraints and contribute to international business exploration (Andreas and Vangelis, 2008; Zhang et al., 2012, 2016). The empirical work shows that there is a positive relationship between decision to internationalize and strategic alliance between SMEs and local institutions such as research institutions, local industry group and government (Ojala, 2009; Prashantham and Birkinshaw, 2015; Zhou et al., 2007), as well as business and political ties (Zhang et al., 2016).

The literature has highlighted that networks play a great enabling role in the internationalization of firms (Tang, 2011; Zhang et al., 2016). For instance, the empirical work of Coviello and Munro (1995) on the internationalization of software SMEs found that network can influence their modes of entry choices and markets. Firms engaged in international networks tend to grow rapidly and achieve greater successes for market entry in that their network partners can understand entering firms' resources and capabilities (Bell, 1995; Coviello and Munro, 1997). A good example for this understanding of firms' capabilities by the network partners and mitigating it through helpful mechanisms would be the use of quasi-hierarchical modes such as strategic alliances for operations in foreign markets where the firm lacked relational social capital and brand recognition. As such, the foreign partners' local *social networks* in their local country markets can greatly help the firm's internationalization process (Chetty and Campbell-Hunt, 2004). Furthermore, in cases where the psychic distance between the home and host market is great, the firms' lack of social networks in the host market can be mitigated by alliances for example.

The *business networks* have been traditionally linked with *social networks* in the Chinese context. The business groups, as a new organizational form in China, have been seen as facilitating companies to pursue global growth opportunities (Yiu et al., 2007). The institutional

networks have also found to be important factors especially for the Chinese firms to internationalize and through these network companies can reduce risk arising in the foreign markets due to information asymmetry (Liu et al., 2008; Zhang et al., 2012; Zhang et al., 2016). Also, Chinese SMEs can leapfrog into foreign markets by building on their strong, locally based social networks (Lin, 2010; Zhou, 2007; Zhang et al., 2016).

Through repeated and frequent interactions with network partners, commitment and trust are accrued through *social networks* (Bucklin and Sengupta, 1993; Larson, 1992), and firms can generate trust and develop relationships with other members within these networks, thus facilitating their internationalization process (Chetty and Patterson, 2002; Chetty and Agndal, 2007). This social capital has been termed as Guanxi in extant literature and has been determined to reduce transaction and search costs for doing business in China. As such, firms confronted with uncertainty in entering new markets, reduced their risks by depending on their relationships and contacts (Ellis, 2000; Ellis and Pecotich, 2001; Tang, 2011; Sandberg, 2014). Particularly in the emerging market, very recent research on SMEs found that firms' social network structure was important for their expansion and growth (e.g., Prashantham and Birkinshaw, 2015; Zhang et al., 2016).

Studies also point toward the role of ethnic ties in internationalizing firms location choice decisions (Jean et al., 2011). Ethnic ties are based on informal social relations such as common language, place of origin and belonging to a particular ethnic group (Zaheer et al., 2009). Zaheer et al.'s (2009) study suggests that ethnic ties were far more important than cluster related capabilities for service offshoring location related decisions in India. Similarly, Jean et al.'s (2011) note that ethnic ties were the determinant factors for Taiwanese business groups' location of investment decisions in the context of Chinese market. Internationalizing firms can utilize these ties to interact and develop strong connections with a diverse network partners, including suppliers, customers as well as government (Gao, 2003). Yet to date there are limited studies which have examined the role of ethnic ties along with business network ties in influencing EM-SMEs internationalization (Jean et al., 2011; Prashantham et al., 2015; Zhang et al., 2016).

In all, the network viewpoint on the internationalization of SMEs provides a useful framework for explaining such firms' interrelation among the resources, activities, and actors in the internationalization process. Furthermore, the above studies view the international market as a web of networks and SMEs can benefit from external resources residing in such networks in order to overcome resource constraints (Tang, 2011). However as stated in the introduction of this article the relative role and influence of different types of network ties on emerging market SMEs is under examined and this paper aims to contribute to the network as well as emerging market SMEs internationalization literature.

## **Methods**

### **Research Context**

In the Chinese SMEs context, it is important to understand that governmental policy impacts these firms as the Chinese institutional framework for business is significantly different from most of developed economies. Until the late 1970s, China was a planned economy. Every sector was controlled by the state (Spar and Oi, 2006), thus the state-owned enterprises (SOEs) dominated the Chinese business environment. As China transitioned from the planned economy to the market economy, the government of China began to reform the state-owned enterprises and promote the development of private enterprises. Since then, the SMEs have been growing rapidly. By the virtue of their unique advantages in technology and resources, these firms have developed capabilities for competing with SOEs in the local market. Recently, SMEs constitute 98 percent of Chinese firms, 65 percent of the country's patents, 60 percent of China's GDP, and 75 percent of its new products (Forbes, 2012). Interestingly, the SMEs are responsible for 68 percent of China's exports (Cardoza et al., 2015). These figures demonstrate the importance of this relatively neglected context of the Chinese economy and this study is pertinent to understand the internationalization of such SMEs in China and the role of networks in their internationalization strategies.

## **Multiple-Case Study**

This research explores the influence of the network relationships on Chinese SMEs' internationalization process, and more especially, to explain how network relationships of these firms affect their internationalization strategies. Also, this work explores the impact of different stakeholders in the network on SMEs' internationalization process. The multiple-case study method has been used to examine how network relationships influence internationalization process, including the country selection process, modes of entry and cross-border activities and to further evaluate which types of networks have been useful for their internationalization. A case study is “*a strategy for doing research which involved an empirical investigation of a particular contemporary phenomenon within its real context using multiple sources of evidence*” (Robson, 2002, p.178). This method of multiple-case studies allows the study to explore the phenomena of internationalization through the use of a replication strategy. The multiple-case approach helps in the development and evaluation of patterns mutual to cases and theory and prevents chance associations (Eisenhardt, 1989).

## **Sample, Data Collection, and Analysis**

This research adopted qualitative exploratory interviews to collect the data and interviews were conducted with the founders and managers of four Chinese manufacturing SMEs. The interviews were conducted during the summer of 2013-2014. Using purposive sampling technique, our sample was restricted to manufacturing industries to prevent extraneous discrepancy that can emerge from differences between service and manufacturing sectors. Also, the four companies used in this study belong to four different industries in manufacturing sector. To be more precise, these Chinese manufacturing SMEs belong to automobile accessories (Firm A), shoes (Firm B), candlelight (Firm C), and sewing machine (Firm D) sectors respectively. All these four case firms are actively engaging in upstream and downstream business operations in several foreign markets. The information on our case firms is provided in Table 1. To maintain the confidentiality of the case

firms, we have used letters to represent these firms.

< *Insert Table 1 around here* >

All data was collected primarily from these four Chinese SMEs and respondents were the founders of the firm or its top management who were more acquainted with the internationalization process of the selected firms or directly engaged in the decision-making process of global activities, serving in the company for more than two years. The interview questionnaire consisted of two parts: general information (about the respondent and company) and information related to their internationalization process and the role of various network in internationalization. These questions consisted of both open-ended as well as closed-ended questions. We interviewed between two to three respondents from each SME, each of which lasted between 60 to 90 minutes and these interviews were tape-recorded. After interviews, we conversed via telephone with these respondents on a number of times for confirmatory responses as well as discussing our research analysis and results. Along with these interviews, we collected supplementary data from several relevant social networking websites and also through informal discussions with industry experts and product brochures. The details on our case companies' internationalization activities are presented in Table 1. We followed the standard protocol of qualitative data analysis (Miles and Huberman, 1994). We prepared individual case summaries and then performed within and cross-case analysis.

## **Findings**

The findings indicate significant differences in the foreign market choice and entry modes of the studied SMEs. The data suggest that both business and social networks: ethnic ties and MNEs-oriented business networks played an important role in the internationalization of the SMEs. Some of them have also used temporary networks such as trade fairs to gain knowledge related to internationalization.

### **Overview of case firms**

The case *Firm A* is an automotive valve and tail pipe manufacturer, and *Firm C* is a candlelight

manufacturer targeted international market at the time of their inceptions. For instance, the Firm A focused on valve and tail pipe niche market in the automobile sector that the MNEs typically ignore. Given this situation, Firm A observed that they can benefit from their favorable SMEs-related features and gain foothold as well as earn profit in the foreign market. Similarly, before going global, Firm C conducted a thorough international market research and found that there was a huge demand for candlelight products in foreign markets. Their research showed that developed countries accounted for more than 75% of the global market share. Also, this research showed that products made by glass accounted for 25% of the market. These glass products are common and cheap in China. Thus, firm C identified a business opportunity and developed products targeted for international markets based on unique glassed Chinese candlelight products.

Compared with the above two firms, *Firm B* and *Firm D* began their international business activities, 21 years and 11 years after their foundation. Firm B, a shoes manufacturer, gradually worked toward gaining an ISO 9000 accreditation and set the top ten Italian shoe firms as its quality benchmarks for its products prior to their internationalization. The case firm also imported advanced manufacturing equipment from several of the world leading markets such as Italy, the U.K, and Taiwan. Technological learning from advanced economy firms provided Firm B with a strong quality know-how in order to successfully enter into foreign markets where quality assurance was much higher compared with the domestic Chinese market.

In case of Firm D, it not only lacked the services of qualified and foreign markets experienced staff, but also international business networks, which delayed the firm's internationalization. Nevertheless the international business manager of Firm D was resourceful and through Yellow Pages got in touch with some sewing machine dealers in Hong Kong culturally close to China. The case firm's effort on exploring a business partner in Hong Kong led to the manager making the acquaintance of the chairman of one Hong Kong based sewing machinery firm. This business partner provided Firm D technical guidance on various aspects of conducting international business operation. Through this partnership, management of the case firm also

became knowledgeable on new markets including Africa and South America.

### **Development and evolution of networks in influencing the internationalization process**

The findings show that the case firms' initial foreign network development and paths of their evolutions varies as they adopted low-commitment oriented market entry to fully committed strategies. As illustrated below, however we find that the four Chinese SMEs' internationalization process started with the help of a series of actors in each firm's network relationships which evolve into diverse network relationships. Each firm's international intention and network relationships greatly facilitated their successful internationalization.

*Firm A's* internationalization approach was based on pre-developed stable relationships with clients in penetrated foreign markets. Then, it established more independent operations in these markets. The case firm used various entry modes to enter foreign markets. To cope with different market conditions, its entry mode choices were flexibly tailored to characteristics of each market. Prior to internationalization, this firm was interested in the U.S. So, it recruited employees who have experiences in North America, and actively sought business partner through various channels. In order to establish global presence and brand awareness, the firm actively attended trade exhibitions in the U.S. Such participations greatly helped to develop some initial business connections with potential partners. Few of them later evolved into the firm's strategic partners For instance, the case firm established a sales subsidiary in the form of a joint venture in the U.S with two local companies. One of them has more than one hundred branches, specializing in producing trucks, transmissions, and other automobile and component products. The case firm largely benefitted from the partnership due to its extensive supply chain channels. Attributed to the success of the partnership, the case firm was able to expand its product lines including new valve products and tail pipes. Such new products are now directly provided to three big auto makers in the U.S

*Firm B* has run shoe stores in multiple foreign locations including Paris, New York, Rome, Prato, Milan, Naples, Barcelona, and other cities in seven countries since 2001. Firm B's

Senior Manager stated three reasons why they choose Europe as its foreign market:

*“Firstly, shoe-making industry belongs to labor-intensive industry. As China has a large population and the labor force is abundant. Secondly, it is illustrated that shoes in developed countries rely on importing. This implies that there was a viable market and China has an international business opportunity to exploit. Last but not least, overseas Chinese network has great economic value to our firm. A great deal of overseas Chinese themselves is a huge consumer groups, as they have a particular preference for ethnic products.”*

On the grand opening day of the firm’s shoe store in Paris, Chinese customers visited the store and purchased many products which accounted for 40 percent of the sales of the opening day for example. In fact, the firm was offered by several interested overseas Chinese buyers via overseas exhibitions. Firm B rapidly internationalized using a series of Chinese social networks relationships to enter foreign countries. As exemplified earlier, overseas Chinese population greatly helped the firm open new stores in Europe. The manager of this firm stated, *“the firm utilized effectively the resources and capabilities of overseas ethnic Chinese network and ties played important role in establishing a foothold in international markets.”*

The firm also entered into cooperative arrangements in Europe by forming joint venture. This cooperative manner of doing business helped the firm to gain market knowledge and overcome operational risks. The case firm’s factory is based in Wenzhou in China, and there are more than forty million overseas Chinese from Wenzhou around the world. When Firm B put an advertisement of finding partners in European Times, more than 50 overseas Chinese expressed the intention to cooperate and the case firm chose one experienced company as a partner. In so doing, Firm B established a joint venture responsible for the development and operation of stores in France. Afterwards, it decided to develop business networks in host country’s shopping malls to enter the main channel through concessionary stores. Through informal connections, it friendly invited French retail professionals to discuss about the firm’s French operations. Thanks to this kind of informal connections, the firm was able to sign a cooperation agreement with one French store chain and till date it has opened five concessionary stores in France.



Along with these relationships, the evolution of the firm's network was supported by Shoe and Allied Trades Research Association (SATRA), a global footwear research organization established in the U.K. Many of the world's leading footwear brands are members of SATRA, using SATRA's technical standards. SATRA provided the firm with technical know-how related to product technology, quality, testing, and technical standards. In 2004, with assistance of SATRA the firm built laboratories and eventually signed a cooperation agreement with SATRA. The agreement required Firm B to invest 10 million Yuan to establish footwear R&D research center to develop new materials for shoe manufacturing. The manager of Firm B said, "*cooperation with SATRA solve the problem of how China's footwear industry in line with international rule*".

**Firm C** was dedicated to develop high-class and attractive candlelight products to enter developed country markets. After initially exporting to these markets, it plans to strategically develop a long-term collaborative relationship with Wal-Mart in the largest U.S market, and then building up a U.S-based service center covering North and South American territories. The firm's products were sold to Wal-Mart through its export agents based in Hong Kong and Taiwan. The firm approached Wal-Mart to leverage Wal-Mart's abundant resources and global management capabilities through forming a partnership. After a year of negotiations, Firm B passed this giant retail MNE's audit standards to be its business partner. This partnership was a stepping stone for the case firm to understand global market opportunities. Based on this valuable experience and learning from business cooperation with Wal-Mart, the firm was able to supply products for big foreign retailers such as German Metro and French Carrefour. It has developed long-term relationships with 17 of Fortune 500 companies.

The development of business relationships with foreign partners allowed the case firm to develop additional business opportunities through partners' abundant business networks. Besides business relationships with retail MNEs, those of other MNEs in different sectors (e.g., Marlboro, Samsung, and GE) also helped increase volume in sales. Firm C ranks the third position in the global candle industry. The case of Firm C shows that SMEs from emerging countries involved in

internationalization often lack marketing experiences, but they could overcome such hurdles by allying with network-abundant MNEs from advanced economies.

*Firm D* is the only case firm that had chosen developing country markets such as Africa. It had achieved high levels of technology and brand recognition in sewing machines compared to a low level of technology available in Africa at that time. In addition, compared to its European and U.S competitors, the firm also had cost-leadership advantages which could appeal to their African customers. Firm D was limited by its brand awareness in global markets and its scale of business. To overcome this liability of newness and smallness, the firm firstly exported its products via agents to Africa and Latin America. Later on, the firm employed technological experts from developed countries such as Japan, America, and Canada to learn technological skills and know-how, thus developing high quality products for international markets. The firm's continuous investment in R&D helped to develop trust of its foreign clients, which in turn greatly contributed to increasing exports to developed country markets.

In fact, Firm D later encountered a negative country-of-origin image when it attempted to establish its presence in the U.S. In order to change the negative image, the firm commissioned a local consulting firm in the U.S to help study marketing plans for the U.S customers. The firm sent versatile household sewing machines to the country's 97,000 schools, and enabled these schools to open sewing classes. Such marketing practices helped reduce some of the negative country-of-origin perception. Over the years, the firm has set up foreign marketing and sales subsidiaries and actively cooperated with their international distributors. The firm also attended trade fairs in Europe to establish local contacts. The firm was deeply involved in building international networks which facilitated its internationalization.

### **Chinese ethnic ties**

The section briefly dedicated to the elaboration on the role of ethnic-group based social networks (e.g., family, overseas Chinese, other firms and government), which enables the case firms'

effective foreign market entry and operations.

**Firm B** business operations are embedded in the traditional master-apprentice as well as peers' relationship. This kind of relationship offers foundation for development of cooperation as well as exchange of experience and knowledge, which is later used for internationalization. Wenzhou shoe industry has a long history of development. By the end of 2013, there are more than 4,000 shoe factories in Wenzhou, 'the city of shoes' in China. This inter-corporate social network has been developed by master and apprentice relationship and peers' relationship. The degree of trust between enterprises in Wenzhou is particularly strong. Hence, so long as the firm seeks resources for international development, the other enterprises in this network are likely to help the firm. It is anticipated that one feels more trust and reliability from their family members (Eric and Tsang, 2000). This relationship is more used in China because the Chinese rule is: put your trust primarily in 'your own' people. Through overseas Chinese community, Firm B gained the knowledge related to regulation, political and economic systems of the host markets that influenced the operations in host markets, along with the product demand and products standardization.

**Firm A, C, and D** all three agreed that overseas ethnic Chinese community offered help and valuable guidance for operating in foreign markets. Being based in over 130 countries and with more than 30 million overseas Chinese gave these firms a great source of local market knowledge. Overseas Chinese network has great economic value to these SMEs. A great number of overseas Chinese themselves are part of these firms' clients and consumer groups, as they have a particular preference for ethnic products. One manager described overseas Chinese's network as:

*“a natural channel [to navigate] through the politics and all other foreign market entry related tariff and non-tariff barriers”.*

To summarize, the above findings on the case firms' initial development and evolution of networks challenge the extant literature regarding the choice of foreign market. The four case firms all chose foreign markets which were quite different in institutional environments from their home countries ones, e.g., business practices, culture, language, and industrial development (cf., the

Uppsala model). Also, the markets in developed countries such as the U.S and Europe are well-established and fiercely competitive. So we can infer that the key factor for the case firms to successfully enter foreign markets is their capabilities for developing diverse network relationships. Such inter-firm relationships such as those with suppliers and clients are likely to influence the selection of markets and mode of entry choice for emerging market SMEs (Bell, 1995; Coviello and Munro, 1997; Tang, 2011; Zhang et al., 2016). Network partners guided these firms in terms of their foreign market selection and provided the initial mechanisms and vital knowledge required for entering foreign markets. The internationalization process of these case SMEs was affected and formed by a complex set of network relationships and developed through a diversity of international partners. The evolution and growth of the case firm's networks themselves appear to be results of focal case firms' involvement in various international networks and effective utilization of such networks at both the business and social levels (Zhou et al., 2007; Zaheer et al., 2009; Sandberg, 2014; Prashantham et al., 2015; Pinho and Prange, 2016).

## **Discussion and Conclusions**

Based on internationalization process and network perspectives, this paper investigated whether these theoretical approaches are appropriate for Chinese SMEs. Given the particular characteristics of Chinese SMEs, the internationalization process theory partly explains the progressive internationalization process of Chinese SMEs. The findings suggest that Firm D for instance used its experience and knowledge gained from exporting via agents to develop wholly owned subsidiaries in foreign markets. However, Firm A and Firm C, on the other hand, have been engaged in international activities from their inception by utilizing ethnic networks in foreign markets (Zaheer et al., 2009; Prashantham and Dhanaraj, 2010; Jean et al., 2011). These SMEs proactively attempted to build up business and social networks in foreign market. This finding is consistent with some of existing studies highlighting the important role of networks for internationalization (Oviatt and McDougall, 1994; Chetty and Campbell-Hunt, 2004; Zhou et al.,

2007; Sandberg, 2014; Pinho and Prange, 2016). Interestingly, since most managers in Chinese SMEs have very limited international experience and knowledge, they appear to resort to information they obtain from international social networks. Such networks help SMEs gain information, knowledge and experience from overseas Chinese family members, other firms, and the government. It is also interesting to note that as more and more Chinese returnee entrepreneurs begin to engage with global markets (see e.g., Liu et al., 2015). The reliance of SMEs on such overseas Chinese networks might decrease as these returnees will have their own global networks and partnerships to leverage and support their business activities. It can probably be argued that as Chinese entrepreneurship models and business environment including the institutional environment evolves these business models for SMEs internationalization might converge to these observed in the western context.

### **Diversity of networks contributes to EM-SMEs internationalization**

Due to the relative small size and weak resource base of the Chinese case firms, it is challenging for them to acquire various kinds of resources for their internationalization (Tang, 2011). As such, diverse networks' ties act as a bridge between different parties, providing considerable information to these SMEs which help them in their internationalization. Among networks, the external network members play a vital role in shaping and circulating the flow of knowledge and information through the networks to these SMEs thus facilitating their foreign market entry strategies. The network actors are generally more easily able to gain access to valuable knowledge from other network members such as foreign clients and suppliers and then pass benefits to the internationalizing firms. Scholars have indicated that SMEs have to be in a position to influence their respective networks in order to secure positions within the network (Aaboen et al., 2013; La Rocca et al., 2013).

Ethnic network plays a significant role in transmission of information, financial intermediation, transaction costs reduction, risk aversion and so on as well as foreign market location choices (Zaheer et al., 2009; Jean et al., 2011). For China, especially mainland Chinese

economy, the overseas Chinese business network has become a bridge and link for economic and trade exchanges between China and the rest of the world. In the course of the development of their international operations, all the case firms seized the opportunity to advertise their products at trade fairs and developed important and useful relationships with foreign customers. These trade fairs acted as important knowledge circulating pipelines for the case firms which helped these firms to succeed in foreign markets (Jean, 2014; Lew et al., 2016).

The interaction between the overseas Chinese community and the mainland China is an important resource for internationalizing Chinese SMEs to leverage these ties and expand their international business operations. Furthermore, it is easier to develop an interdependent relationship between this global diaspora and home country businesses which facilitate the internationalization of SMEs. During the interviews, majority of the respondents believed that overseas Chinese have a positive impact on their internationalization process. As a result, these SMEs have broaden the channels and strategies for international growth and market entry and improved their overseas development capabilities via overseas Chinese' network. These findings highlight the important role of informal networks in the internationalization of SMEs (Prashantham and Dhanaraj, 2010; Jean et al., 2011).

Typically, Chinese firms like other emerging economy-based firms are weaker and have poor capability to absorb risks. Working with other firms is a viable strategy to avoid risks. From our case firms, it can be seen that from global networks and co-operations, these firms were able to immediately use existing resources including human resources, financial capability, distribution networks, or research and development organizations which helped in their internationalization. Through cooperation with established firms, SMEs can also gain the knowledge and experience of these firms, thereby enhancing the stock of knowledge of firms during the process of internationalization and reducing foreign market-related risks. As shown in the findings, Firm A's success depended on its business partners in foreign markets. Ties with MNEs were critically important for internationalization and global success of Firm C. For instance, since 1997 it has had

cooperation with Wal-Mart. Also, this firm worked closely with Wal-Mart to develop high quality products that met western quality requirements. Firm D obtained trust and credibility of clients in the U.S through its ties with various network stakeholders. In some cases, MNEs also played a vital role in the internalization of our case firms. So, our cases support for the argument that firms with advanced collaborative capabilities tend to acquire trust and reputation by continuously collaborating with other firms. These findings support the recent research which indicates that MNEs ties are important for the internationalization of new SMEs from emerging economies (Prashantham and Dhanaraj, 2015).

In sum, the diverse network actors have an important role in EM-SMEs internationalization. In our cases, SMEs got access to valuable market knowledge via various network actors including family members, overseas Chinese, as well as MNEs. This heterogeneity among network partners' helps SMEs obtain experiential learning (Beckman and Haunschild, 2002). Therefore, diverse knowledge via third parties helps Chinese SME managers have a better knowledge about foreign markets. This knowledge comprises of information related to local suppliers, competitors, and the dealers in foreign markets. Firms also learn about the required strategies to compete in such markets. Also, heterogeneity of network helps the acquisition of knowledge related to the cultural and social environment in host country which enables the internationalization process of SMEs.

### **Theoretical Implications**

The results indicate two common features of the investigated SMEs in their pre-internationalization stage. First, within the organization, both in the international and the domestic part, the lack of collaboration and effective communication affect the progress of corporate international response capacity. Second, SMEs have '*the Lonely International*' characteristics (Johanson and Mattsson, 1988) in terms of networks: they do not create widespread contacts with foreign suppliers, customers, competitors, distributors, government, and other organizations, thus were presented with

low market share and lost numerous opportunities (Aaboen et al., 2013; La Rocca et al., 2013).

The knowledge and the experience are two key factors in internationalization process. We find that the biggest challenge encountered by the SMEs during the process of internationalization is the lack of knowledge and experience about foreign market and institutional constraints. These firms need support and resources from diverse external network organizations to help them to better perform their activities. These resources contain knowledge, information, experience, and human capital, proprietary technology and adequate funding. In the four cases, they all mentioned the importance of the resources and knowledge for internationalization. Entrepreneurs and decision-makers of Firm C repeatedly stressed that at present the shortage of sales personnel hinders their international business. Similarly Firm D mentioned several times that lack of technical knowledge and market information made the firm take a few detours in its internationalization journey. One of the managers from Firm A also said, *“in the earlier period the biggest difficulty is the lack of funds, which led to slow development; the biggest challenge now is to obtain sufficient information and advanced equipment”*.

In this research, we find that the diverse network relationships and the relative strength of ties with business and social networks of SMEs strongly influence their internationalization in terms of mode of entry and market selection. First of all, the findings support the internationalization process that can be divided into two stages during the preliminary stage of internationalization: (1) market investigation and (2) market exploitation. Hence, firms should develop different networks ties during the different stages of internationalization. At the first stage, the emphasis is on understanding the relationship and accessing the business opportunities through various overseas networks. In this phase, entrepreneurs' personal social networks and intermediate network (e.g., trade shows, consultation, contact the council) become primary market resources for firms to develop their global footprint. In the meanwhile, firms establish initial business relationships with overseas markets. In the second stage, companies often choose partners in foreign markets to meet the business requirements in order to succeed in those markets.



Second, psychic distance has been widely studied in the internationalization process. However, we could not find explicit evidence for the cultural/psychic distance in the case companies. The SMEs choices of foreign market depended on the market opportunity. It is known to all the case companies that market in developed countries is well-established and it is more difficult to enter. However, the case firms are able to effectively enter into developed countries because their products are relevant to these markets and they were appropriately leveraging social network relationships. Third, although these cases did well, it cannot be ignored that the speed of internationalization of such SMEs is rather slow and incremental (partly) due to the historical problems. On one hand, there is almost no attention to non-SOEs from the government of China and private enterprises find it difficult to obtain licenses for exports. Hence, the development of Chinese SMEs is limited at best and their advantages mostly rely on low price and low-quality products strategy.

Although the internationalization process model has greatly influenced the international business literature, some studies have observed that it was invalid in certain contexts. For instance, born-global types of firms are often engaged in international activities from scratch and leapfrog certain internationalization stages by dispersing value chain activities globally (Oviatt and McDougall, 1994; Knight and Cavusgil, 2004). Unlike the traditional risk-avoiding internationalization process model, some SMEs like our four case firms rapidly enter foreign markets and take high risk approach during the quest for internationalization. They take some advantages of valuable resources and capabilities of their diverse business and social networks, including networking with MNEs and ethnic ties. Thus, such emerging market SMEs' internationalization behaviors differ from the traditional firm's internationalization patterns in terms of the time of internationalization and attitudes on foreign market-related risks. Overall the study contributes to the strategy and international business literatures by highlighting the role of both business and ethnic network ties which influence EM-SMEs internationalization.

## **Implications for SMEs**

From a practical standpoint, the findings suggest that managers in SMEs should realize the importance of the effects of different type of network relationships on their internationalization activities. Firstly, firms need to be fully conscious of their common characteristics: the small scale, limited capital and limited access to high level of technology irrespective of their age. Chinese SMEs should take the initiative to build various types of the relationships, particularly the overseas Chinese ethnic networks, so they have opportunity to increase their knowledge of foreign markets. Second, SMEs should leverage business ties with the multinationals in their home market in order to get a foothold in foreign markets. Finally, with the continuous expansion of network relationships, firms can obtain more market knowledge, it is necessary to identify and carefully leverage those network relationships which facilitate foreign market entry.

## **Limitations and Future Research**

The present study has several limitations which offer opportunities for further research. First, we study only four successful SMEs from one emerging market - China. Future studies could benefit by studying SMEs from other emerging economies such as India, Brazil, Russia and South Africa.

Second, the focus of this study was only the private-owned firms. We might observe different impact of business and social network ties on the internationalization process of private-owned versus state-owned small-medium firms. Future studies could compare both private as well as state owned firms, and disentangle the relative importance of these ties on the internationalization and performance outcome of such firms. ~~Second~~<sup>Third</sup>, the qualitative approach adopted in this study is

limited in the generalization of the findings, although recent studies have highlighted the important role of both formal and informal social network for SMEs internationalization (Pinho and Prange, 2016; Prashantham and Dhanaraj, 2015; Prashantham and Birkinshaw, 2015; Sandberg, 2014; Zhou et al., 2007; Chetty and Campbell-Hunt, 2004). Future studies could conduct quantitative study and investigate the impact of both business and social networks not only on the internationalization

process of EM-SMEs, but also their performance and survival in international markets. Lastly, our findings indicate that some of the SMEs were relying on collaborative entry modes to expand into international markets. In line with this, therefore future studies could also investigate the impact of collaborative ties and success of SMEs as well as new breed of high-tech entrepreneurial start-ups in international markets.

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## Table

**Table 1:** Case firms' profile and internationalization activities

<b>Firm</b>	<b>Main products</b>	<b>Foundation year</b>	<b>1st year of internationalization</b>	<b>1<sup>st</sup> foreign market</b>	<b>% of sales from international markets</b>	<b>Foreign market presence</b>
<i>A</i>	Automobile valve and tail pipe	1997	1997	U.S	95 %	U.S, Canada, Germany, Poland, Romania
<i>B</i>	Shoes	1980	2001	France	30 %	France, U.S, Italy, Asia
<i>C</i>	Candlelight products	1993	1997	U.S	30 %	U.S, Europe, Vietnam
<i>D</i>	Sewing machine	1982	1993	Africa	60 %	Africa, South America, North America