PRESENCE IN FOREIGN MARKETS, ETHNIC MINORITY OWNERSHIP AND FINANCIAL PERFORMANCE OF HIGH-TECH SME'S

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Abstract

Small and medium enterprises (SMEs) face strong competition with larger incumbents in a fast-changing globalized economy that undermine their financial performance. For this reason, operating in foreign market could be a valuable solution to pursue growth opportunities and improve their financial performance.
The purpose of the paper is to understand the relationship between SMEs internationalization and their financial performance, and whether this effect is moderated by the presence of ethnic minority ownership. Based on a sample of 10.326 high-tech manufacturing US SMEs, our study reveals a positive relation between the number of foreign markets where SMEs operate and their financial performance. In addition, we demonstrate that this effect is positively moderated by the presence of ethnic minorities in the SMEs' ownership.

Therefore, our findings provide evidence of the strong relationship between strategic choice, in the form of presence in foreign markets, and economic results, as well as on the influence exerted by individual-level mechanisms.

Keywords: Small Medium Enterprises, Ethnic Minority Business, Financial Performance, Strategic Agility, Foreign Market Expansion, Ownership, Microfoundations

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Introduction

Within a fast-changing globalized economy, small and medium enterprises (SMEs) have to face strong competition with larger incumbents (Singh, Garg, and Deshmukh, 2008), leveraging on strategic agility to be more competitive. Scholars refer to strategic agility as the ability to easily adapt in dynamic environments, create different business models, and offer firms alternative business opportunities (Doz and Kosonen, 2010).

Firms can manifest strategic agility by operating in different foreign markets (Doz and Kosonen, 2008). This is because operating in multiple countries involves flexibility and the ability to change direction in light of specific market needs (Sui and Baum, 2014). However, existing research lacks a clear understanding of whether and how strategic agility, in terms of presence in different national contexts, influences SMEs' financial performance. This paper addresses this issue by posing the following research question: how does the presence in different foreign markets influence SMEs' financial performance?

Ethnic minority ownership, defined as the presence in the ownership composition of individuals from an ethnic minority group, may be a particular source of competitiveness (Carter *et al.*, 2010). Ethnic minorities in the ownership composition may have significant effects on the strategy-performance interaction, for example on the relation between the presence of a firm in foreign markets and its financial performance. To date, this represents an open line of inquiry, which leads to the second research question of this paper: how does ethnic minority ownership moderate the relationship between the presence in foreign markets and SMEs' financial performance?

The main purpose of this paper is to examine the impact of strategic agility (measured by the presence in foreign markets) on SMEs' financial performance (measured by SMEs operating revenues) and the moderating role of the ownership identity (measured by ethnic minority ownership).

The paper develops two hypotheses and tests them based on a sample of 10326 high-tech manufacturing US SMEs registered in the Orbis database. The results of the study indicate that the presence in foreign markets is positively related to SMEs' financial performance (and that this effect is strengthened when SMEs are owned by an ethnic minority. In particular, section 2 presents theory and hypotheses; section 3 describes data and methodology; section 4 shows the results, section 5 concludes the paper by discussing key findings, implications, and future research directions.

Theory and hypothesis

SMEs, strategic agility, and presence in foreign markets

Despite their small-scale output and relatively lower scale economies, SMEs are significant contributors to employment growth and innovation and play a critical role in the development of a country (Paul, Parthasarathy and Gupta, 2017). However, SMEs face many challenges while competing with large multinational companies (Paul, Parthasarathy and Gupta, 2017), such as the difficulty to obtain technological capabilities and skilled human capital (Czarnitzki and Hottenrott, 2011), high cost of product development (March-Chordà, Gunasekaran and Lloria-Aramburo, 2002), higher failure risks (Ropega, 2011), and the lack of effective selling techniques and market research (Hashim and Wafa, 2002). For this reason, a growth strategy by international market expansion may allow SMEs to replicate the market niches where they can possibly achieve a competitive advantage, and thereby improve their financial performance (Contractor, Kundu and Hsu, 2003).

SMEs active in different international contexts may ultimately present higher financial performance than their not internationalized counterparts since they benefit from a broader geographic scope (Lu and Beamish, 2006). However, in order to gain these benefits, SMEs need to be strategically agile (Doz and Kosonen, 2010), namely capable to make strategic commitments, while staying nimble and flexible. This capability is indeed considered to be a mean by which organizations may perform better by transforming and reinventing themselves and by adapting to changing environments (Doz and Kosonen, 2010). Operating in foreign markets represents a form of strategic agility (Doz and Kosonen, 2010) since it entails dealing with different customers and different competitive environments (Okręglicka, Gorzeń-Mitka and Ogrean, 2015). For this reason SMEs expanding in foreign markets need to make their products suitable for each different market (Knight, 2001), taking advantage from being agile.

Presence in foreign markets and financial performance of SMEs

The presence of SMEs in foreign markets, which results from a process of adaptation and/or creation of new business opportunities in diverse countries, is likely to improve their financial performance. Indeed, it is well known that SMEs suffer from the current intensive competition that often leads to a small market share for such companies (Steiner and Solem, 1988). Conversely, SMEs that are able to operate in different international contexts may ultimately present higher financial performances than their not internationalized counterparts since they have more likely a larger operating market - benefiting from a broader geographic scope (Lu and Beamish, 2006).

Second, the process that has led to the presence of SMEs in foreign markets entails the necessity to make their products suitable for each different market (Knight, 2001). This means that SMEs have traditionally been able to identify specific customers' needs, augmenting their knowledge about the different operating markets, and putting themselves in a better position to sell their products. In fact, SMEs take advantage of a leaner and more flexible decision-making process and entrepreneurial dynamism (Paul, Parthasarathy and Gupta, 2017) favored by a flatter hierarchical structure that allows to accelerate decision-making and to be more responsive in adapting and modifying their businesses.

SMEs that have expanded their business in foreign markets may lessen the competitive pressure, find new growth opportunities, and more easily pursue a sustainable growth strategy. In this respect, growth by international market expansion is an important strategic option (McDougall and Oviatt, 1994), offering SMEs with the opportunity to discover new and less crowded market opportunities, thus improving their financial performance (Lu and Beamish, 2001). Specifically, the contribution to SMEs' financial performance derived by the presence in foreign markets is linear. By increasing sales through export activities, SMEs improve their financial performance. In turn, a higher sales volume provides the possibility of a higher production volume, which enables to achieve economies of scale and increase labor productivity (Martín Jiménez *et al.*, 1985; Grant, Jammine and Thomas, 1988; Lu and Beamish, 2006). In this way, SMEs benefit from a double source of financial performance improvement: on one side, increased sales; on the other side, cost reduction thanks to the economies of scale. Therefore, it can be argued that:

H1. The higher the presence in foreign markets, the higher the financial performance of SMEs.

The relevance of ethnic minority ownership

Scholars have acknowledged that individuals may be a source of strategic agility (Arbussa, Bikfalvi and Marquès, 2017) This is true especially when they occupy ownership and top management positions, and can make firms adapt in dynamic and constantly changing environments (Lewis, Andriopoulos and Smith, 2014). Specifically, the governance mechanisms of owners affect strategic agility because organizational choices are often the reflection of the values and cognitive bases of powerful actors in the organization (Hambrick, 2007); moreover, ownership identity affects the way through which the strategy is pursued to achieve profit goals (Carter *et al.*, 2010). The ownership identity influences the proclivity to take risks and expand the scale and scope of a firm's internationalization efforts (George, Wiklund and Zahra, 2005; Oesterle, Richta and Fisch, 2013). Similarly, export orientation and performance are positively associated with the presence of a "returnee" entrepreneur (described as a professional returning to his/her home country after a period of education or work abroad with an acquired international experience and an expanded network of potential partners) (Filatotchev *et al.*, 2009).

The moderating role of ethnic minority ownership

In this context, cultural diversity in the ownership board has been underlined for its potential to affect the effectiveness of internationalization strategies (Bock *et al.*, 2012). Indeed, the presence of ethnic minority in the ownership structure strengthens the relationship between strategic agility and financial performance by bringing heterogeneity and multiple perspective and attitudes. There are several reasons for that.

First, according to a resource-dependent perspective, difference in ethnicity will very likely produce unique information sets that are available to management for better decision making.

Second, ethnic minorities show distinctive traits in terms of: natural trading instinct (Wauters and Lambrecht, 2008), achieving higher results (Meadwell, 1989), attention to the community (Jamal, 2003), access to a close network of potential partners (Ram and Smallbone, 2003), compliance with social value patterns. Eventually, the international strategy of minority-owned SMEs will increase the number of potential markets and trigger more business opportunities that can improve financial performance. Third, owners belonging to an ethnic minority are more prone to approach different foreign cultures (Freedman and Barth, 1970), and this is likely to be reflected across the whole organization given their top-management position and the flatter structure of SMEs. Consequently, SMEs will experience increased effectiveness of operating in foreign markets, with particular regard to the possibility to understand, satisfy, and learn from more diversified, international customers (Altinay, Saunders and Wang, 2014). Fourth, the higher disposition towards external opportunities encourages and amplifies the process of learning from the new international contexts (Michailova and Wilson, 2008). Last, the general risk aversion of people belonging to ethnic minorities fosters the choice of pursuing (low-commitment and low-risk) internationalization strategies (Johanson and Vahlne, 2009).

Following the foregoing discussion, the presence of ethnic minorities in the ownership composition reinforces the expansion in foreign markets by SMEs, thus further increasing prospective benefits on financial performance. Stated more formally:

H2. The relationship between the presence in foreign markets and the financial performance of SMEs is positively moderated by the presence of ethnic minority in the ownership structure.

Data and methods

Data collection

Data for hypothesis testing were collected from the Orbis database (Buerau van Dijk). Specifically, a sample of high-tech manufacturing US SMEs was taken into account. It should be noted that the US context was chosen because US SMEs manifest a peculiar strategic intent to move into foreign markets to improve their competitive potential (OECD, 2004). Furthermore, ethnic minority issues are particularly evident in the US context, that is one of the countries with the highest variance of ethnicities, including ethnic minorities, thus allowing a better examination of the phenomenon of ethnic minority ownership (Froy and Pyne, 2011). The choice of focusing on high-tech manufacturing SMEs lies in the fact that market expansion is especially evident for such type of SMEs, as compared to SMEs belonging to low-tech and/or service industries (Spence and Crick, 2006).

In detail, for data collection, a search was made in the Orbis database for US companies classified as SMEs and belonging to high-tech sectors - as identified following sector industrial codes suggested by (Gomez-Mejia *et al.*, 2014). Among all the identified firms, the sample was restricted to 10.326 SMEs for which information on financial performance (in 2017) and ownership was available.

Variables

The dependent variable of the study (*Financial Performance*) was measured as the natural logarithm of a SME's operating revenue (see Collins-Dodd, Gordon, and Smart, 2004). The independent variable (*Foreign Markets*) was calculated by counting the number of main foreign markets in which a SME operates (Ellis, 2007), as indicated in the Orbis database. The moderating variable (*Ethnic Minority Ownership*) is a binary variable taking the value of 1 if a SME is recognized as minority-owned by the Orbis database – that is when a SME is at least

51% owned by, and whose management and daily business operations are controlled by, one or more members of a socially and economically disadvantaged minority group.

Control variables were added to improve the reliability of the analysis. First, firm age (*Firm Age*) (Sørensen and Stuart, 2000) computed as 2017 minus the incorporation year was considered. Second, a variable considering the firm size (*Firm size*) in terms of number of employees (Damanpour, 1992) was added. Third, in order to take into account the level of innovativeness of a SME, the number of patents it owns (I*nnovativeness*) (Hall, Jaffe and Trajtenberg, 2005) was calculated. Fourth, the number of branch locations recorded worldwide by an SME (*Branch Locations*) (Hoopes, 1994) was taken into account. Fifth, regarding the ownership structure, information was gained on the number of recorded shareholders (*Shareholders*) (Amihud, Mendelson and Uno, 1999), included a dummy variable in case a SME is also a woman-owned enterprise (*Woman Owned)* (Piperopoulos, 2012), and considered the share of family owners who are also managers (*Family Management)* (Block, 2011). Finally, dummy variables controlling for an SME's main sector (*Dummy Sectors*) were included.

Results

Table 1 and Table 2 show descriptive statistics and pairwise correlations respectively. Correlation values are all below 0.70, thus limiting multicollinearity concerns (Cohen *et al.*, 2003). An ordinary least square (OLS) regression with robust standard errors was used to test the hypotheses. Indeed, a cross-sectional dataset where the dependent variable assumes continuous, not censored values (Wooldridge, 2015) was built. Table 3 presents the results. Model 1 provides the baseline model, including control variables and the moderating variable (*Ethnic Minority Ownership*). Model 2 adds the independent variable (*Foreign Markets*). Model 3, the full model, includes the coefficient estimates of the interaction term *Ethnic Minority Ownership* X *Foreign Markets*.

Table 1. *Descriptive statistics*

Variable	Mean	Dev. Std.	Min	Max
1-Financial Performance	6.40	1.16	5.52	8.92
2-Foreign Markets	.017	.38	0	19
3-Ethnic Minority Ownership	.13	.34	0	1
4-Woman Owned	.131	.34	0	1
5-Family Management	1.83	13.19	0	100

6-Shareholders	.24	.62	0	13
7-Innovativeness	.97	10.44	0	919
8-Branch Locations	.34	1.36	0	26
9-Firm Size	9.23	14.48	1	75
10-Firm Age	21.86	15.93	0	187

Table 2. *Pairwise correlations*

	1	2	3	4	5	6	7	8	9	10
1-Financial Performance	1									
2-Foreign Markets	0.02*	1								
3-Ethnic Minority Ownership	-0.04*	0.04*	1							
4-Woman Owned	-0.01	0.02*	0.35*	1						
5-Family Management	0.12*	0.02	0.01	-0.01	1					
6-Shareholders	0.04*	-0.00	-0.05*	-0.04*	0.27*	1				
7-Innovativeness	0.06*	-0.00	-0.02*	-0.02	0.07*	0.10*	1			
8-Branch Locations	0.19*	0.01	-0.04*	-0.02*	0.02	0.01	0.04*	1		
9-Firm Size	0.51*	-0.00	-0.04*	-0.02*	0.20*	0.08*	0.06*	0.15*	1	
10-Firm Age	0.23*	0.01	-0.07*	-0.04*	0.09*	0.04*	0.02	0.05*	0.21*	1

*p<0.05

Table 3. *Table 3. OLS results with robust s.e.*

	Model 1	s.e.	Model 2	s.e.	Model 3	s.e.
Foreign Markets			.038**	.018	.032*	.018
Foreign Markets X Ethnic Minority Ownership					.508***	.158
Ethnic Minority Ownership	-.061**	.030	-.060**	.030	-.063**	.030
Woman Owned	.038	.030	.039	.030	.038	.030
Family Management	.001	.001	.001	.001	.001	.001
Shareholders	-.024	.020	-.025	.020	-.025	.020
Innovativeness	.003**	.001	.003**	.001	.005**	.001
Brach Locations	.099***	.008	.100***	.008	.099***	.008
Firm Size	.037***	.001	.037***	.001	.037***	.001
Firm Age	.009***	.001	.009***	.001	.009***	.001
Dummy Sector						
Constant	5.81***	.045	5.806***	.045	5.801***	.045
F statistic	161.22***		153.31***		145.04***	
R2	0.2919		0.2920		0.2924	

N=10326; *p<0.10; **p<0.05; ***p<0.01

According to model 1, the financial performance of SMEs is positively related to a SME's innovativeness (β=0.003, $p<0.05$), number of branch locations (β=0.099, $p<0.01$), firm size (β=0.037, p<0.01), and firm age (β=0.009, p<0.01), whereas it is negatively related to ethnic minority ownership (β=-0.061, p<0.05). Model 2 supports Hypothesis 1 since the linear term of Foreign Markets is positive and significant (β=0.038, p<0.05). For robustness, in a separate model, the presence of curvilinear effects was tested by adding the quadratic term of Foreign Markets. The quadratic term was found not significant, hence confirming the initial conjecture. Model 3 proves in line with Hypothesis 2. Indeed, the interaction term Ethnic Minority Ownership X Foreign Markets is positive and statistically significant (β=0.508, p<0.05). To gain additional insight into the moderating effect of Ethnic Minority Ownership, a simple slope analysis (Toothaker, Aiken and West, 1994) was carried out. Different levels of Ethnic Minority Ownership - high (when a SME is ethnic-minority owned) and low (when a SME is not ethnic-minority owned) – were included.

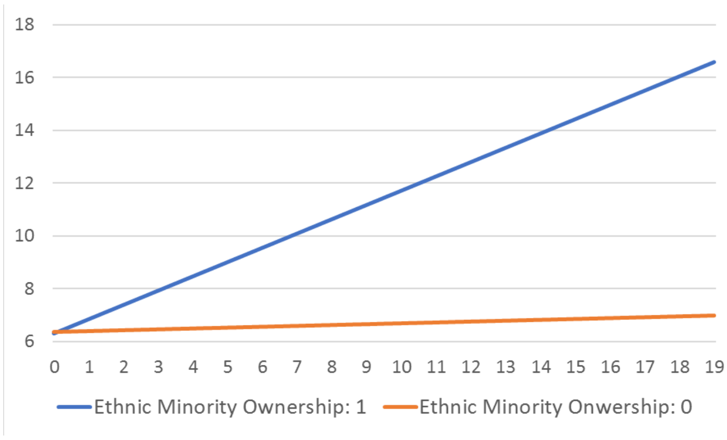

Figure 1. *Robustness check for the effect of Ethnic Minority Ownership*

Afterward, the effect of Foreign Markets on Financial Performance was plotted for both levels of Ethnic Minority Ownership (Figure 1). Figure 1 provides further support for Hypothesis 2 since higher financial performance manifests at the high level of Ethnic Minority Ownership.

Discussion and conclusion

Based on a sample of 10.326 high-tech manufacturing US SMEs, the present study examines the relationship between the presence in foreign markets and the financial performance of SMEs, revealing a positive and significant relationship, which can be ascribed to theories related to strategic agility. In addition, we also assessed the influence of the presence in foreign markets on SMEs' financial performance, showing that the presence of ethnic minority positively moderating the relation between the number of foreign markets and SMEs' financial performance.

The study contributes to literature of SMEs internationalization and financial performance, seen through the lens of strategic agility. Also, it adds to literature of strategic micro-foundations by providing the missing link between firm's internationalization and owners' identity. Indeed, the idea of the moderating role of the owners from ethnic minorities in the strategic agility-financial performance relation is here suggested; our research stands as one of the first attempts to consider this moderating factor on this relationship, especially in the SMEs context.

The present research addresses important implications for the practitioner side. First, we advise managers to expand into foreign markets, thus developing agility to compete in different environmental and market contexts, in perspective of a financial performance improvement. Managers are advised that they may elude the competitive pressure of the larger competitors by exploiting their resources to expand in foreign markets. Second, practitioners should take advantage of the lean structure of SMEs where ownership and management often overlap (Brunninge, Nordqvist and Wiklund, 2007), and convert it into an advantage by assigning a major role to the human element in the shape of the owner, which plays a key role in a SME. Indeed, the ownership structure of a SME would be positively affected by the presence of an individual belonging to an ethnic minority, especially with a view to an internationalization strategy through foreign market expansion. This presence may give a positive boost to the expansion operations, adding a superior value to the process and empowering the internationalization strategy. This may mean that, in defining the ownership structure (for example, in the start-up phase), ethnic minority people should not be neglected, especially if a SME intends to operate or is already operating in different national contexts. In turn, these outcomes could be helpful for funding organizations and/or venture capitalists by providing them with an additional lens to assess the SMEs.

The widespread diffusion of SMEs and their increasing importance in any national economy (Amini, 2004) has attracted the attention of policy makers. These should be aware that it is important to stimulate SMEs' export orientation, maybe by facilitating the legal procedures to sell in foreign markets, hence favoring the connection between foreign countries through ad-hoc agreement, which may encourage such export orientation of SMEs, and introducing incentives for exporting activities. In addition, policy makers should consider the positive effect of ethnic minority on the strategic agility-financial performance relation for SMEs, thus supporting the inclusion of ethnic minorities in SMEs ownership, for example through a potential advantageous treatment.

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