

# A Review of International Mode of Entry Strategies for SMEs in East Java

*Review Article*

## ABSTRACT

The purpose of this research is to examine the internationalization of Small and Medium-sized Enterprises (SMEs) in East Java from both theoretical and practical perspectives. By analyzing existing literature and utilizing empirical data from earlier studies, this study seeks to deepen our understanding of the subject matter. The methodology of this study involves rigorous examination of the most recent theories and models, supplemented by empirical analysis of existing research on internationalization of SMEs. Various theories and models, ranging from classical to contemporary approaches, are explored in relation to the internationalization strategy of SMEs in East Java, and different entry modes for internationalization. The theoretical framework of this study is anchored on the resource-based view and network theory. This study uses content analysis of the latest theories and models coupled with empirical analysis of studies on the internationalization of SMEs that have been conducted. Several theories and models, both classical and new approaches, link the internationalization strategy of SMEs in East Java and several entry modes for internationalization. This theory is based on a resource-based view and network theory. The result of this study is East Java's SME internationalization strategy is hampered by various obstacles and issues, as per documented evidence. While the entry mode for internationalization hinges on networking, numerous SMEs in the region choose to network autonomously, as empirical data suggests. This study aims to provide policymakers, especially the government, with workable ideas for a long-term, proactive strategy to ensure the success of SMEs' internationalization in East Java. Empirical data proposes that limited knowledge about markets, trade regulations, communication barriers, financing, and transportation infrastructure supporting internationalization pose the most common challenges faced by SMEs in Indonesia. Consequently, the entry networking strategy mode is the key to independent internationalization for SMEs. This study contributes to a theoretical and practical review of SME internationalization

*Keywords: East Java; Internationalization; Mode of Entry Strategy; Small Medium Enterprise*

## 1. INTRODUCTION

Internationalization has been a topic of fascination across multiple disciplines in recent years, including organizational theory, marketing, strategic management, international management, and small business management. This phenomenon encompasses global decision-making and control, international activity progression, and factors supporting or impeding large and small companies' internationalization. With the current market's nature, small and medium-sized enterprises (SMEs) face global problems like large corporations. For companies in high-tech and manufacturing industries, the risks [1] and opportunities [2]; [3] presented by foreign or global competition must be acknowledged for business operations.

Several dimensions come into play when examining a company's internationalization process. One of the most important aspects is the strategic entry mode that firms choose when they initially decide to go international and how their choice of entry mode changes over time as they enter more foreign markets. The decision to enter a foreign market must be based on weighing the risks and opportunities of this approach. However, there is evidence that it also depends on resource availability [4]; [5], control needs [6], marketing skills [7], innovation [8], and networks [9]. Internationalization not only brings opportunities but foreign risks and responsibilities must also be addressed, which can lead to increased costs of doing business abroad. Therefore, it is necessary to understand market knowledge, country image, and cultural and institutional differences.

Established multinational corporations' domination over SMEs, particularly global corporations, has garnered widespread attention in international business. Some countries, driven by the balance of payments deficits, are pushing for increased international activity among their SMEs to stimulate economic growth, reduce unemployment, and potentially create small-scale multinational corporations [1];[10]. SMEs' development and sustainability hinge heavily on internationalization and innovation [11], with exporting as the primary market entry method. For many SMEs, exporting is also a crucial strategic step towards expansion [12]; [13] and the main avenue for achieving international growth.

Firms engaged in exporting are also involved in various interplaying internationalization activities [14]. Entry and subsequent development of international markets is difficult for any medium-sized company. Many companies use traditional marketing methods and trial and error [15]. The main disadvantage is that more information about market opportunities is required, and even management cannot find sufficient resources to effectively exploit these opportunities [16].

Following World War II, economic internationalization surged forward and remained unchallenged until the early 1970s, when the new concept of globalization emerged. This term refers to companies with worldwide operations instead of being confined to specific countries. Changing marketing and production conditions have put traditional exports under increasing pressure, obliging modern corporations, including SMEs, to respond to the market more quickly. Globalization also entails the functional integration of geographically dispersed economic activities, resulting in a more extensive scope, content, and intensity of interrelationships, capital, and management involvement. This dynamic represents a qualitative internationalization extension [17]. While studies on SME internationalization vary in their normative implications for which internationalization strategy to pursue, one thing is clear: Companies must adapt to the rapidly changing conditions of the global market. It is essential for performance and survival [18]. Strategies must be designed according to organizational conditions to achieve maximum performance [19].

Small and medium enterprises (SMEs) have been instrumental in advancing Indonesia's economy [20]. The Ministry of Cooperatives and Small and Medium Enterprises reported 64.2 million SMEs active in Indonesia in 2020, comprising 99.9% of the country's total businesses. These SMEs also account for 61.07% of the gross national income (GDP) and 97% of the employment rate, indicating that the government must prioritize their sustained [21]. SMEs have contributed significantly to expanding employment and business opportunities, increasing regional development, and promoting national economic growth [22]. Relying on their advantages, small and medium enterprises invest in brand development and go to foreign markets [23]. Therefore, SMEs deserve to be considered in the international market [24]. Internationalization also allows SMEs to survive amid intense competition [25]. SMEs in Indonesia are increasingly considering international expansion as a strategic option for sustainable growth [26].

Although small and medium-sized enterprises have made contributions to economic development, they are also facing enormous challenges. If these challenges are properly addressed, the economy will improve. The contribution of SMEs to efforts such as poverty alleviation keeps the economy growing well. It reduces crime and creates unemployment [27]. The challenge for SMEs is to create a competitive advantage amidst increasing domestic and global competition [28].

Small and medium-sized enterprises (SMEs) face a dual challenge and opportunity due to the rise of globalization and internationalization. While increased competition looms as a threat, SMEs can explore avenues such as external cooperation, market-entry, and exports. With the advancements in cross-border networks and communication, SMEs may take advantage of new global opportunities. However, to excel in the export market, SMEs must elevate their product quality to meet international standards. It is worth noting that exporting can positively affect a country's economic growth and productivity [29].

Various hurdles faced by Small and Medium Enterprises (SMEs) in Indonesia when it comes to exporting [22]. Firstly, the global trade landscape demands high market responsiveness, especially regarding consumer behaviour. Secondly, there is a need to diversify the design, form and function of manufactured products, which still needs to be improved. With their limited diversity, SMEs tend to produce traditional products/services with a comparative advantage, such as clothing, textiles, and leather products like shoes or wood, which makes them distinct in the SME sector. Thirdly, for product export, SMEs need more access to productive resources, especially concerning financial, informational, advertising, technological and networking aspects. Lastly, entrepreneurs' international orientation, which is positively interrelated with internationalization strategies, often poses a significant obstacle [30]. The importance of the internationalization of SMEs in Indonesia and the obstacles accompanying them are interesting things to study and discuss what kind of entry strategy mode is being implemented by SMEs in Indonesia to achieve internationalization.

## 2. THEORETICAL LITERATURE

### 2.1. Classical Approach towards Internationalization of SMEs

Internationalization theory has very different models with different criteria and classifications. There is no generally accepted theory to explain internationalization. The dynamics of researchers' approaches in the field of internationalization evolve with changes in the world economy. Theories explaining entry patterns can be categorized into stage theory, eclectic paradigms, resource-based models, REM models, Wiklund models, resource-based models, analytical models, and network perspectives [29]; [31].

The internationalization stage theory is a well-established and vital area of research exploring export strategies for small businesses. This approach assumes that firms initially establish themselves in domestic markets and gradually expand their international activities through several stages [31]. Empirical research conducted by Johanson and Vahlne of Uppsala University's business studies department in the mid-1970s showed that Swedish companies often begin their internationalization efforts through temporary export. They take small, measured steps to develop these activities, initially partnering with intermediaries representing major foreign companies. As their sales grow, they replace these intermediaries with their own sales organization. Finally, to overcome trade barriers, they begin manufacturing in foreign markets. This approach proved particularly important for SMEs in the post-World War II era. The researchers labeled this dimension of internationalization pattern the *establishment chain* (Figure 1).

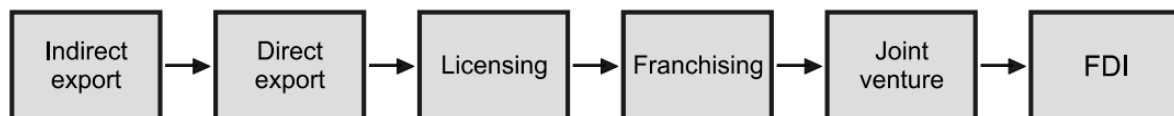


Figure 1. The Establishment Chain of Internationalization Stages

Source: [31]

The Uppsala model shows that market knowledge and participation affect Internationalization decisions and current operations [32]. The Uppsala model interprets internationalization as incremental learning development, where firms gradually acquire knowledge of external markets before increasing market exposure. Johanson & Vahlne (2009) extend their original 1977 Uppsala model to discuss outsider liability. At its core, it is about how markets and networks can be brought closer together. In this modern era, networks like insiders are essential to successful internationalization [33]. Such a network allows for building trust and market loyalty as well as research Show that network relations play an important role in the internationalization process [34]. Network theorists see the internationalization of firms as the development of network relationships with foreign individuals and firms [35].

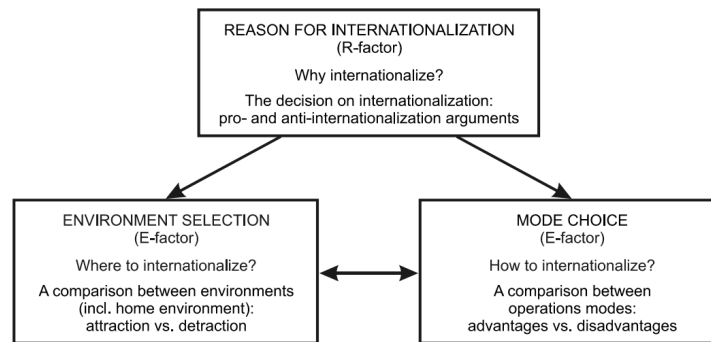
The topic of foreign production in internationalization is the focus of Dunning's eclectic paradigm, an extension of the Uppsala model. The three fundamental principles that underpin this theory are drawn from multiple theoretical frameworks, leading Dunning to describe his approach as an "eclectic". According to this, a company will produce internationally if it meets the following conditions [31]:

1. For a company to make foreign direct investments, it must possess advantages that its domestic competitors do not. These "owner-specific advantages" could take the form of superior production technology, marketing, organizational knowledge, tangible and intangible assets, or other readily transferable factors. Entering a foreign market requires a company to have a competitive edge that can outstrip domestic businesses' familiarity with the local business environment.
2. Internalization - The firm internalizes the use of its proprietary advantage. The main reason companies internalize markets is often uncertainty. The greater the uncertainty, the greater the firm's advantage. Take control of the transaction yourself. Internalization is particularly prone to occur in this situation. Some knowledge transfer is required. Another reason to internalize is the price mechanism. In the external market, prices are quoted by buyers and sellers. On the other hand, prices in the domestic market are settled between related parties in the same organization.
3. A specific location can offer numerous advantages, including the profitable acquisition of overseas assets, which may surpass domestic opportunities. The varying income levels of different countries result in different demands for goods, with the mix of products demanded varying with income. The size and composition of markets also serve as crucial location-specific factors. Additionally, a company's perception of psychic distance, language, culture, national government's political climate, and attitude towards foreign direct investments hold significant importance. Lastly, variations in production costs make up another crucial group of location-specific factors.

The developmental aspects of the stage model are consistent with some elements of the resource-based view of the firm proposed [36]. Resource-Based View (RBV) It is believed that enterprises have resources, some of which can give them a competitive advantage and some of which can lead to superior long-term performance. Valuable and rare resources can create a competitive advantage. This advantage can be maintained Over longer periods, where firms can protect themselves from resource imitation, transfer, or replace. Overall, empirical research using the theory strongly supports the resource-based perspective. The key points of the theory are:

1. Identify potential key resources for the company.
2. Evaluate whether these resources meet the following criteria (VRIN): Valuable, Rare, In-imitable, Non-substitutable.

The REM model describes and explains the internationalization of post-soviet firms (Figure 2). The largest Soviet companies are analyzed: GAZPROM and LUKoil. Due to the lack of data on Soviet enterprises abroad, the only possible approach is case studies. Moreover, GAZPROM and LUKoil can own huge assets compared to foreign competitors' resources and are global companies.

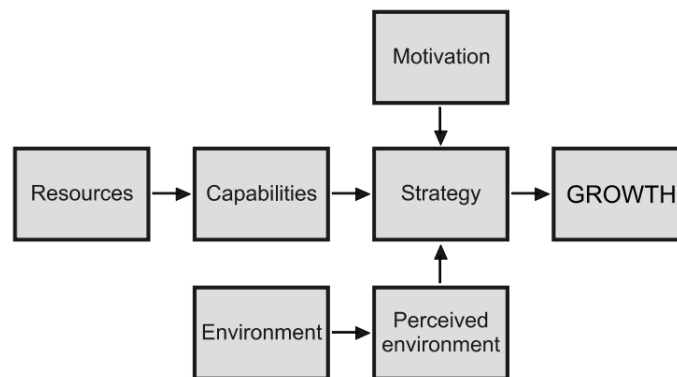


**Figure 2. The REM Model**  
Source: [37]

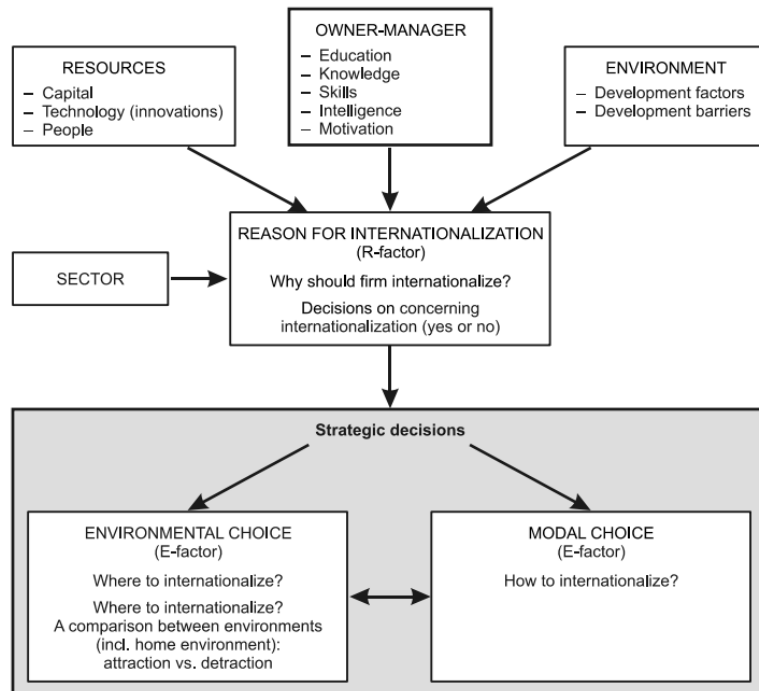
While the REM model remains the only suggestion to detail the internationalization of SMEs in a transition economy, multinational corporations could also find it applicable in small business internationalization. If the industry operates in a market economy, other models are more appropriate. The resource sector model, for instance, builds on two distinctive assumptions [31]:

1. Internationalization hinges on the pivotal role of the owner-manager.
2. Small and Medium Enterprises (SMEs) consider numerous determinants when making strategic decisions. Among these factors are resources, environment, and industry considerations.

Except for the REM model, Wiklund's growth model was used to construct the resource sector model (Figure 4). It is because firms that seek growth enter the foreign market (to grow/develop).



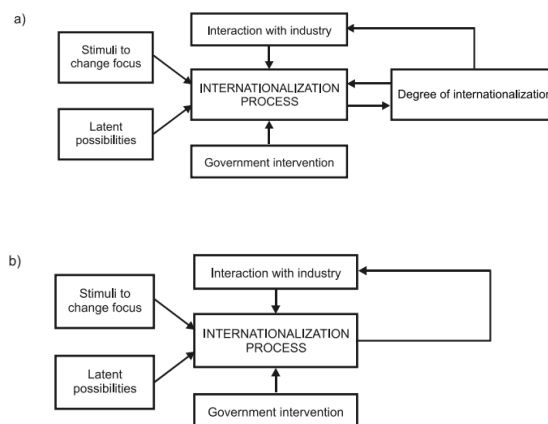
**Figure 3. Wiklund Model**  
Source: [38]



**Figure 4. Resource-Sector Model of SME Internationalization**  
Source: [31]

The Wiklund model (Figure 3) places the owner-manager in an essential role. Their knowledge and expertise are crucial in determining the potential use of other resources. Strategic decisions, in turn, are influenced by the perceived environment, which is highly dependent on the owner-manager motivation and ability to leverage available resources. The smaller the gap between the environment and the owner-manager perception, the greater the likelihood of successfully implementing the chosen strategy. The size of this gap is directly related to the owner-managers awareness, knowledge, experience, and access to information. It is, therefore, critical to maximizing the effective use of available resources such as knowledge, experience, and skills. The symbiotic relationship and collaboration form the cornerstone of the company's expansion. Although growth is essential, more is needed to foster the company's global expansion.

When analyzing internationalization, Figure 5 offers two scopes to choose from. The first, Figure 5a, zooms in on outcomes, enabling predictions, goal-setting, and measurement. The second, Figure 5b, focuses on the process itself. Choosing between these depends on the study's intended purpose.

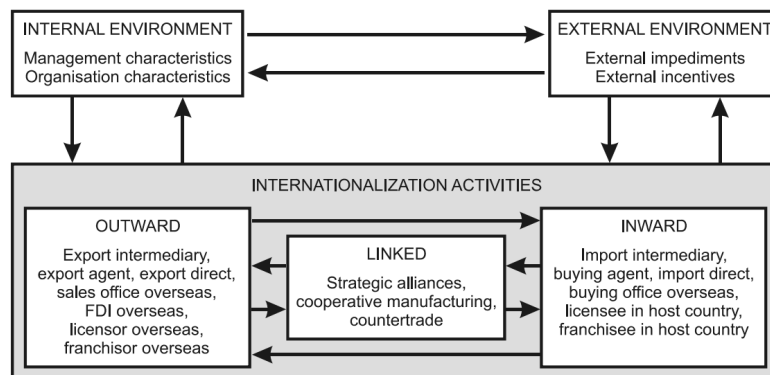


**Figure 5. Internationalization: a) focus on outcome, b) focus on process**  
Source: [39]

## 2.2. New Approach towards Internationalization of SMEs

There are three new methods for internationalizing SMEs, namely holistic approach, comprehensive model and knowledge-based model [31]. Undoubtedly, internationalization is a multidimensional and intricate phenomenon. The points above, albeit valid, are typically narrow in scope, focusing solely on one element of a company's international operations. Research often centres around the factors that propel internationalization or the process of becoming progressively more global. Many influences drive internationalization, as noted by Richard Fletcher, who introduced a comprehensive framework for business internationalization. The model encompasses three distinct forms of international activity: outbound (such as exports), inbound (such as imports), and linkages (such as strategic alliances). These categories mutually implicate one another and are equally affected by internal and external factors. According to researchers, Small and Medium Enterprises (SMEs) are divided into three "channels" of internationalization. These channels include gradual penetration of foreign markets (known as "traditional" firms), rapid internationalization ("born global"), and entry into foreign markets as a traditional company, but with an accelerated pace of penetration (reborn global). The study also highlights the importance of knowledge factors in SMEs' internationalization, such as market and empirical knowledge (acquired through networks, culture, and entrepreneurship). This knowledge-based model provides crucial insights into the role of knowledge in SMEs' internationalization and is grounded in major Entrepreneurship and Internationalization Paradigms [31].

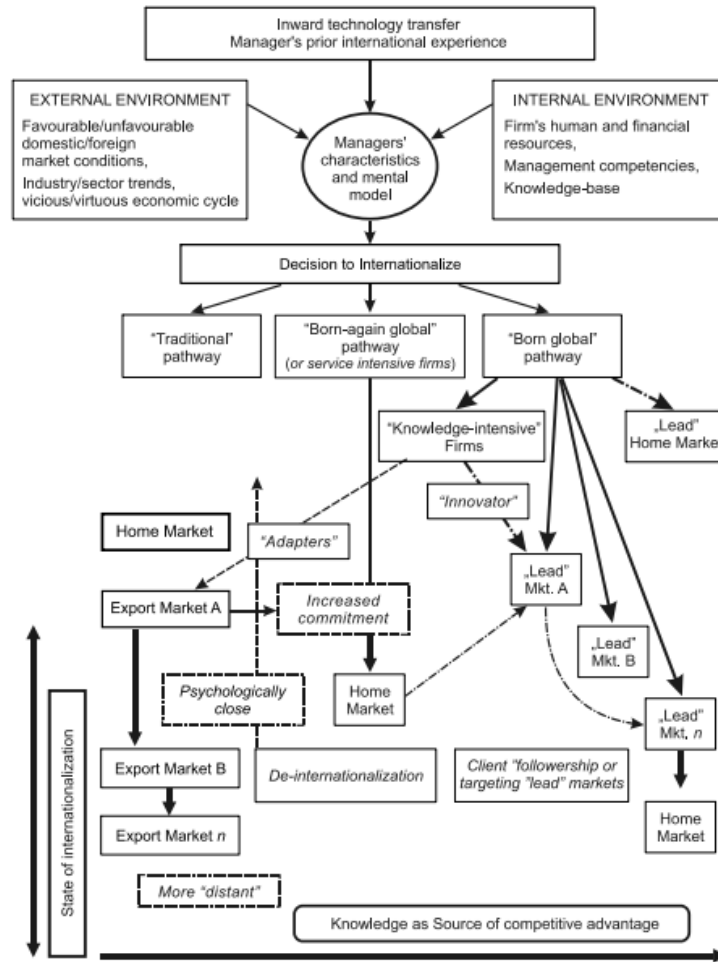
Presented in Figure 6 is a comprehensive model for a holistic approach to internationalization, highlighting the interconnectivity of outward, inward, and associative forms of internationalization. The diagram illustrates that the factors that impact outward internationalization also influence the other forms. It also underscores how external and internal internationalization mutually enriches one another. The framework further elucidates that relevant forms of internationalization are stimulated by either external factors, such as a desire to export, or internal factors, such as a need to control the supply of hard-to-acquire overseas products.



**Figure 6. A holistic approach to internationalization**

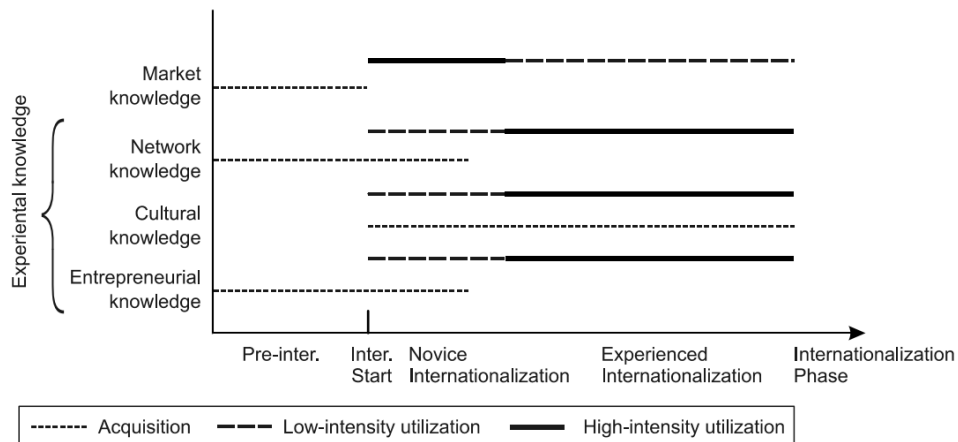
Source: [40]

The canonical international model (Figure 7) is based on the extensive internationalization literature and contains many empirical studies on the process of "born global" firms, including researchers' observations of the "reborn global" phenomenon.



**Figure 7. An integrative model of small firm internationalization**  
Source: [41]

The knowledge base model (Figure 8) is an added stage to the stage model of internationalization from a knowledge perspective.



**Figure 8. A knowledge-based model of SME internationalization**  
Source: [42]

### 3. EMPIRICAL REVIEW

In November 2020, representatives from Indonesia, China, Japan, South Korea, Australia, and New Zealand gathered to discuss the Regional Comprehensive Economic Partnership Agreement (RCEP)—the most tangible form of regional cooperation. RCEP's primary objectives are to spur investment and trade development, cultivate exclusive and high-quality economic partnerships, and contribute to worldwide economic growth. It also aims to create job opportunities and bolster businesses. The Ministry of Trade predicts that RCEP will increase GDP by 0.05% and reduce it by 0.07% between 2021 and 2032, compared to the scenario without RCEP [43].

The below-par export and competitiveness records of Indonesian SMEs can be traced back to their limited capacity to innovate, which hinders the process and implementation of ideas. As a result, their products often need more selling value and can't compete with imported goods with an edge in one aspect or another, such as lower prices. Various resources like capital, human resources, technology, research, development, and external factors such as marketing orientation fuel innovation. Indonesian SMEs often grapple with these factors, as highlighted by [44]. Recently, Sultoni et al. (2022) discovered that improving brand awareness and product quality is essential for Madura SMEs to be more appealing in the global market. Similarly, the research shows that limited resources, complicated international trade procedures, and a lack of overseas marketing channels challenge the internationalization of Magetan's leather craft business [46]. Furthermore, that several problems in the context of heading to an international market in the culinary cluster UKM represented by the Bakso Klenger UKM, Jember Regency, had been identified based on fish bone analysis techniques. The main problem for going to the international market for Klenger Meatball UKM is the technology, both in terms of Human Resources (HR), Materials, and Methods [47].

Talented and globally competitive human resources are a determining factor for the success of MSMEs. Excellent human resources can be obtained through increasing human resources with formal and informal education. Excellent human resources who can manage MSMEs by utilizing local wisdom, both tangible and intangible local wisdom, so that each MSME has uniqueness and advantages of each MSME. With the intelligence and skills possessed by MSMEs, MSMEs can manage existing local wisdom so that MSME products can compete in international markets [48]. Empowerment of local wisdom is closely related to the ability of local communities to utilize natural and human resources as needed to create a balance. Local wisdom is the value of life development based on each region's empowerment skills and local potential. Local wisdom is the value of life development based on empowering local skills and potential from each region. Effective MSME empowerment is expected to increase their productivity so that, in turn, it will strengthen the nation's economy and competitiveness. Creative industries with local insights are sources of knowledge that are dynamically developing, continuing in the form of entrepreneurial behavior, and can become a creative inspiration for MSME entrepreneurs.

Small and medium enterprises in Indonesia, particularly in East Java, grapple with numerous challenges. Foremost among these are inadequate working capital and investment and difficulties in marketing, distribution, and procurement of raw materials. These problems are compounded by limited access to market information, HR expertise, and technological capabilities. SMEs also face high costs in transportation and energy, communication, and bureaucratic administration, including obtaining business licenses. Economic policies that need more clarity or direction add to the uncertainty. Innovation is critical, and the relationship between innovation and organizational resources and skills is a key factor for Indonesian SMEs to remain competitive in the global marketplace [22];[45].

According to Cahyadi's research in 2016, PT Heat Transfer Solusi Indonesia (PT HTSI) is a mid-sized firm that produces and supplies heat transfer equipment in Surabaya. They have undertaken several projects in Bangladesh and Malaysia, where they had to navigate differences in local policies and work cultures, which can cause significant project delays. Consequently, it is crucial to collaborate closely with local partners who possess a deeper understanding of the business environment. Another concern is securing funding for these projects, which is challenging due to high implementation and investment costs [24].

According to recent research, PT Kusmajaya (PT KJ) is a moderately-sized furniture manufacturer in Malang. PT KJ has been primarily concerned with exports since 2008, striving to expand its footprint in the burgeoning overseas furniture market. Its products are sold directly or indirectly to the United States, Europe, and Asia. The furniture sector is fiercely competitive, with China, India, and Vietnam dominating the market. PT KJ's products are generally priced higher than its competitors, but many consumers prioritize cost over quality. In conducting business with foreign customers, cultural considerations are crucial. PT KJ is mindful of the significance of communication and the necessity for a well-equipped logistics infrastructure [24]. Fellow in the furniture industry,

namely Aida Pasuruan Furniture, can survive in the export of furniture production, implementing the right strategic model to continue free trade flows. Aida Pasuruan Furniture uses a production strategy that is characterized and serves orders based on customer wishes which are integrated through innovation, product improvement, and then applying social capital through expanding business networks [49].

The type of MSME ownership needs to explain an MSME's influence on export intensity. The export intensity of an MSME in East Java is determined more by R&D, which plays a negative role in export behavior and income/sales considerations that can positively contribute to export intensity. The negative role of the innovation control variable (R&D) is because MSMEs perceive innovation as a transaction cost; if MSMEs incur costs for R&D, it will reduce the production costs that must be incurred by MSMEs [50].

A study by Roida et al. (2010) discovered that some small and medium enterprises (SMEs) utilized brokers to facilitate their export activities instead of exporting their products directly. While brokers help SMEs to internationalize, they also control all information, leaving SMEs to act solely as providers of goods, accepting orders indirectly from buyers. This practice has both positive and negative impacts on SMEs. Meanwhile, Yudiastuti discovered the story of CV Arjuna 999, a fruit chip shop based in Batu City, East Java [52]. The owner underwent a rigorous internationalization process, which included several rejections due to perceived low product quality. After much deliberation, the decision was made to utilize social media platforms for online marketing. The owner of a typical Indonesian souvenir business based in Hong Kong immediately responded. Their products, which rely on local wisdom, have been successfully marketed to nearly all ASEAN countries and even expanded to the Middle East, including various crispy and frozen chips. Utilizing Instagram as its primary platform, the business operates with a dedicated team managing partners such as FB, Shopee, and Content. Networking through social media has proven to be an effective strategy for entering the market. Similarly, UKM woven bag artisans in Ngawi have adopted this strategy to maintain their network and attract buyers from abroad [53].

CV Arjuna Flora, a flower export enterprise, began its internationalization journey with Japan and gradually expanded to Taiwan, the Netherlands, and Nepal through its Japanese network. Numerous challenges plagued the initial phase of the export implementation. However, CV Arjuna Bunga overcame these hurdles by prioritizing its MOU commitments, even at the cost of incurring losses. This dedication fostered a favourable impression, propelling the company to expand its customer referral network. By adopting a networking approach, CV Arjuna Flora and CV Arjuna 999 successfully executed their internationalization mode entry strategies [52].

The influence of networks in export activities is strengthened [54]. The progress of the Jimbe creative industry highly depends on the network's efficiency, as it directly affects its performance. A well-developed network will lead to improved versions of SME's drum jimbe. One such SME, Kendang Jimbe, exports its products to China. The network aims to boost production volume while reducing production costs. It is achieved by establishing a vast network of raw material suppliers whose role is to support the production of raw materials. Furthermore, the owned distribution network ensures the accuracy of overseas shipments. Strengthened by the results of the study that Kendang Jimbe is a wooden craft is a unique traditional musical instrument that is a leading commodity in the Blitar region, which is extracted mainly to China, with the initial form of the internationalization process following the Uppsala and Networking Models [55].

#### **4. CONCLUSION AND RECOMMENDATION**

This research focuses on the internationalization of SMEs in Indonesia, specifically East Java, exploring the obstacles and strategies involved. SMEs have a significant role in the nation's economic landscape, contributing to employment and growth while laying the foundation for new industries and bolstering the economy. However, despite their importance, East Java SMEs still require internationalization assistance. This study examines the challenges and entry strategies that affect the internationalization of SMEs, drawing on empirical data that highlights the many difficulties Indonesian SMEs face in their internationalization efforts. After analyzing empirical data, we discovered that SMEs frequently encounter hurdles such as insufficient market understanding, communication barriers, trade regulations and policies, lack of financing, and poor transportation infrastructure. The strategic network access model is the preferred method for SMEs to pursue internationalization independently. As a result, this study offers a practical and theoretical review of SME internationalization entry strategy models, which can help policymakers overcome these challenges and encourage internationalization. By studying the challenges that SMEs in East Java

often face, we recommend the following strategies to facilitate the internationalization process of Indonesian SMEs:

- a. To promote climate-friendly business development, the government focuses to promote climate-friendly business development; the government focuses on nurturing small and medium enterprises (SMEs). A favourable policy environment is essential, which should be transparent and not impose excessive burdens on SMEs.
- b. Efficiency and the actual requirements of SMEs drive the formulation of SME programs, focusing on market-oriented, demand-driven solutions. The key objective is to promote the efficient growth of SMEs by improving their productivity which in turn fuels their sustainable growth.
- c. Unbalanced structures and access gaps can be maintained in the face of the economic challenges of globalization and free competition. This relevant reform can open up space for SMEs to catch up with the right strategy. The government's role in providing facilities and infrastructure is very important to support the smooth internationalization process.
- d. The challenges of globalization and free competition often result in perpetuating unbalanced structures and access gaps. However, with relevant reforms, SMEs can find their footing and close the gap with a well-executed strategy. In this regard, government support in providing necessary facilities and infrastructure plays a crucial role in enabling a smoother internationalization process.

This paper's empirical study on SME internationalization is confined to East Java. Future research should consider gathering empirical evidence from various parts of the country. It could shed light on decision-making processes for the government as well as acquire a more comprehensive understanding of internationalization strategies for SMEs in Indonesia.

## COMPETING INTERESTS

Authors have declared that no competing interests exist.

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