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LEGITIMACY CHALLANGES FOR SMES IN TRANSITION ENVIRONMENTS TRYING TO ACCESS INTERNATIONAL MARKETS

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Abstract

The paper looks at the legitimacy challenges experienced by SMEs in transition environments – environments that go through institutional transitions. These contexts are characterized by high level of uncertainty where the norms, values, standards that guide organizational behavior are not clearly established. Small organizations are even more vulnerable because they import to a larger extent instability from the environment in which they function due to their small size and consequent lack of resources. The legitimacy challenges are associated with the different types of liabilities experienced by SMEs – liability of origin, smallness and foreignness and the interaction among them. In order to manage their legitimacy, the small enterprises adopt certain strategies – import legitimacy signals from more stable environments and/or try to self-organize themselves. The role of national and regional governments is also emphasized in the process of development of policy instruments that stimulate the growth of small enterprises.

Purpose:

The aim of the paper is to explore the challenges in legitimacy management experienced by small enterprises in transition environments which try to internationalize their activities.

Design:

Conceptual paper

Findings

The legitimacy challenges of SMEs in transition environments are related to the interaction between different types of liabilities – origin, foreignness and smallness. The higher the liability of origin, the higher the intensity of liability of smallness and foreignness. The higher the level of liability of smallness, the higher the intensity of liability of foreignness.

Research limitations/implications:
This is a conceptual paper and its limitations are in terms of the generalizability of results.

Practical implications:
In order to increase their survival chances, the founding team members have to use valid signals of legitimacy. The implications for public policy are associated with the adoption of policy instruments that can be used to decrease the level of liabilities experienced by SMEs in transition environments.

What is original/ what is the value of the paper?
The originality of the paper is in the fact that it examines legitimacy challenges for small enterprises in highly volatile contexts where the legitimacy *per se* can be hardly established.

Keyword: legitimacy challenges, transition environments, SMEs, liabilities, strategies

LEGITIMACY CHALLENGES FOR SMES IN TRANSITION ENVIRONMENTS TRYING TO ACCESS INTERNATIONAL MARKETS

1. Introduction

The purpose of this article is to explore the legitimacy challenges for small- and medium-size enterprises (SMEs) in transition environments. It is well-known that growing SMEs generate wealth and innovation, and contribute to employment (Doern, 2009). One way of SMEs to grow is to access the global markets or in other words, to internationalize their activities (Lu & Beamish 2001). In this process, they face the challenge to match the requirements and expectations of the different stakeholder groups residing at the environmental layer they are aiming at accessing (from national to international layer). Or in other words, they face the challenge of demonstrating that they are legitimate players. The difficulties of the SMEs operating in transition contexts are rooted from one side in the economic, political and cultural-cognitive context. The low level of institutionalization characterized with high level of uncertainty and volatility is the basis for most of the challenges experienced by the small enterprises. On the other side, they have to cope with their small size and non-familiarity with the international/global markets. Hence, the main question we ask is: what are the specific legitimacy challenges the SMEs operating in transition environments face when they try to access the international/global markets? This question is part of the larger question: what are the barriers for growth for SMEs in transition environments?

In fact, we group the legitimacy challenges experienced by the SMEs operating in transition environments into three categories, called liabilities – *liability of origin* (related to the context where the company operates), *liability of foreignness* (related to the unfamiliarity with the foreign market which it aims to access) and *liability of smallness* (related to its size). Moreover, their respective components are identified and examined. In addition, some ways to overcome the liabilities are discussed.

The article is organized as follows. First, we look at the concept of organizational legitimacy, followed by the specificities of the transition environments. The article continues with a brief presentation of the SMEs and the challenges faced by small enterprises evolving in transition environments that are willing to internationalize their activities. We conclude with some recommendations on how these challenges can be successfully overcome.

2. Organizational Legitimacy

The concept of legitimacy exists on the borderline between the organization and its environment (Baum & Rowley, 2005: 6). “Legitimacy provides the linkage between organizational and societal level of analysis” (Dowling & Pfeffer, 1975: 131) and helps researchers understand the relationship “organization-environment” by providing some insights on organizational viability and survival (Scott, 2001: 158).

There are two main theoretical approaches to organizational legitimacy – strategic (Ashforth & Gibbs, 1990; Pfeffer & Salancik, [1978] 2003) and institutional approach (DiMaggio & Powell, 1983; Meyer & Rowan, 1977; Scott, 2001). The difference in the way the two schools interpret organizational legitimacy comes from the different way they view the organization, the environment and their relationship (Kraatz & Zajac, 1996). The strategists adopted a technical perspective that regards organizations as rational actors functioning in a complex environment (Thompson, [1967] 2003) “within which a product or a service is exchanged in a market such that organizations are rewarded for effective and efficient control of the work process” (Meyer & Scott, 1983: 140). Hence, they emphasize the exchange interdependencies (Meyer and Rowan 1977) in place between the organization and its task environment (Thompson, [1967] 2003).

On another side, the new institutionalists regard the organization as being confined by its environment (Tolbert & Zucker, 1983) since it is a reflection of the prevailing societal myths (in the form of institutionalized practices and procedures) rather than actors involved in exchanges with their environment (Meyer & Rowan, 1977). The organizational environments are perceived as comprised of “cultural elements, that is taken-for-granted beliefs and widely promulgated rules that serve as templates for organizing” (DiMaggio & Powell, 1991: 27-28). Thus, neo-institutionalists emphasize the institutional rather than the technical aspect of the organizational environment (Meyer & Rowan, 1977). In general, institutional environments have a broader definition – it is the meaning system in which an organization resides (Palmer & Biggart, 2005) and it includes norms, standards, and expectations held by relevant constituencies (Kraatz & Zajac, 1996).

Hence, the basic difference between the two approaches lies in the fact that while the strategists adopt a managerial perspective and view organizations as being able to use actions (Ashforth & Gibbs, 1990) in order to get (or maintain and repair) societal support, the institutionalists regard the manager's decisions being constructed by the same belief systems that determine audiences' reactions. Hence, the latter adopt a more passive view on organizations as merely accepting the norms and expectations imposed by the outer system, which makes organizations in fact choose from a pre-defined set of alternatives.

A very important property of organizational legitimacy is the fact that it is socially-constructed (Berger & Luckman, 1967), which means that it does not lie in the organization itself. Rather, legitimacy is a condition which the organization has accomplished based on relating with the environment and accepting certain rules and norms of the larger societal system (Pfeffer & Salancik, 2003 [1978]: 194). This way the environment exercises certain external control on the organization (Pfeffer & Salancik, [1978] 2003: 43).

Even if the above-mentioned differences between the strategic and institutional approach to organizational legitimacy do persist, the line between them is not a clear-cut. Indeed, all the theories regarding legitimacy are converging on the ideas that "organizations actively participate in the social construction of the environment" but their ability to exercise strategic choice is constrained by the socio-cultural environment, in which they exist (Lawrence, 1999: 161).

In accordance to the converging theoretical approaches, Suchman (1995) adopted an integrative approach to organizational legitimacy, integrating both the strategic and institutional dimensions of legitimacy. He also explicitly acknowledged the role of the different social constituencies (or groups of stakeholders) in the legitimation dynamics by stating that "legitimacy is a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within socially constructed system of norms, values, beliefs, and definitions" (Suchman, 1995: 574).

Based on Suchman's definition of organizational legitimacy, we define the latter as *the perception that an organization adheres to the evaluating audiences' requirements and expectations.* The state, in which the different groups of stakeholders do not share the perception that an organization matches their requirements and expectations, is called a liability. Hence, liabilities are pre-conditions that determine the need for any organization to engage into actions in order to eventually meet the requirements and expectations of the evaluating audiences.

Establishing legitimacy is especially difficult for organizations in transition environment (environments that go through institutional transitions) since the standards, norms, rules against which the legitimacy claims of the evaluating audiences can be matched are not clearly established. In the section below, we present the specificities of the transition environment.

3. Transition Environments

The transition environments are contexts that go through *institutional transitions* - "fundamental and comprehensive changes introduced to the formal and informal rules of the game that affect organizations as players" (Peng, 2003: 275). While in more general terms, the transition is the process of change from one identified state to another one, the institutional transition includes a shift from one institutional framework to another one. A concrete example of environments in transition is the emerging market economies. An economy is considered *emerging* or *developing* (the terms are often used interchangeably) when it meets two criteria: 1) a rapid pace of economic development, and 2) government policies favoring economic liberalization and the adoption of free-market system (Hoskisson *et al.,* 2000). The emerging economies include the so-called *transition economies* – economies that go through a change from centrally-planned economic mechanisms towards freer markets (Ahlstrom & Bruton, 2010). No matter whether an emerging economy is considered a transition economy or not, it goes through a process of institutional transition (Peng, 2003) meaning that there is a shift from one institutional framework (which implies less developed market mechanisms) to another one (which implies more developed market mechanisms). Economies that go through these pervasive and comprehensive changes of the formal and informal institutions (Peng, 2003) represent *transition environments* or *contexts*.

There are numerous classifications of the emerging economies in the world. The International Monetary Fund (IMF) classifies 150 countries as emerging economies based on the composition of the countries' export earnings and other income from abroad (Tham, 2011). The Financial Times Stock Exchange (FTSE) list considers 6 advanced and 16 secondary emerging markets, the Economist's list – 24, Standard and Poors' list – 19, and Dow Jones' List – 35 country markets, respectively (Tham, 2011).

Emerging market economies attract the attention of practitioners and researchers for several reasons. They account for a substantial part of the international trade growth – BRICS[1] countries represent 18% of global trade and 45% of current growth (Tham, 2011). In addition, eight out of ten of the most populous nations are emerging market economies. Their large populations represent an important economic asset. China, India, Indonesia, Brazil, Pakistan, Nigeria, Bangladesh and Russia account for 52% of the world's total population with high potential internal demand (Tham, 2011). Even though emerging economies vary in terms of their size, income per capita and level of industrialization, a common characteristic of these markets is the fact that they are undergoing institutional transitions[2] and are considered transition contexts.

The process of *institutional transition* comes close but it is in fact different from the process of institutional change. Institutional change is a continuous process comprised of three stages – institutionalization (new institution formation) (Scott, 2001), deinstitutionalization (fading away of the existing institutions) (Dacin & Dacin, 2008; Oliver, 1992) and reinstitutionalization (the adoption of new institutions) (Greenwood *et al.,* 2002 (see Fig. 1).

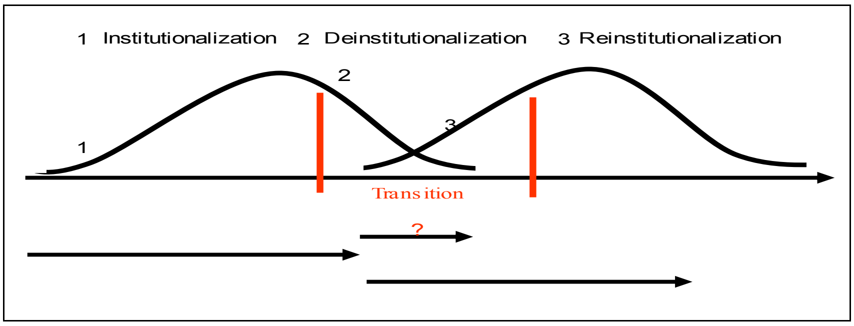

Fig. 1: Institutional Transition as a Stage in the Process of Institutional Change

The transition stage is a specific period in the process of institutional change when the old institutions fade away but have not disappeared and the new institutions started emerging but have not been completely established yet. Hence, there are two overlapping and/or no one institutional framework to guide actors' (including organizations') behavior. This situation is called *institutional vacuum*, which creates an enormous uncertainty for all actors within the

[1] BRICS countries are Brazil, Russia, India, China and South Africa.

[2] The differences among the emerging economies are huge and they vary from the social norms and culture to the levels of environmental uncertainty and business risks (Acquaah, 2007).

system due to the elevated transaction costs (Meyer, 2001). The latter results from the unclear regulatory frameworks and the abundance of opportunistic behavior due to the lack of formal sanctions (Tsui-Auch & Möllering 2010), unreliable market information, and underdeveloped institutions (i.e. the court systems) (Acquaah, 2007; Meyer 2001). The environmental instability produces ambiguity and uncertainty in the rules of exchange among the economic actors (Hitt *et al.,* 2000).

The direct consequences of institutional transitions on organizations are associated with the fact that they experience shortsightedness due to their operational embeddedness and unclear vision for the future. The organizational shortsightedness (myopia) implies they can hardly plan for the long-term future and their span of activities can be predicted for maximum of several months (sometimes weeks). The organizational myopia can be explained with the overall institutional upheaval (Peng & Heath, 1996) and the resulting efforts to constantly adapt to the environment. Organizations lose sight on the long-run merely because their survival in the short run requires their constant attention and effort exertion. Two factors lead to organizational shortsightedness in transition environments – *operational embeddedness* and *unclear vision for the future*.

As a result of the risks associated with daily operations, which in more mature and stable environments are routines, organizations become focused on ensuring the continuous process of operation. Herein, the embeddedness in day-to-day activities is called *operational embeddedness* – the operational limits on long-term planning. In example, lacking of basic infrastructure (water, electricity, roads), insecurity in the banking sector, inter-firm indebtedness and other factors lead to interruptions of firms' operations on a daily basis. This embeddedness in the day-to-day activities leads to lack of long-term sight for the future.

In addition, when the environment changes in a profound way, the organizations do not know what the desired future state of things is simply because they have not experienced it and have not established a benchmark for comparison. Thus, if left on their own, with no imported models of behavior (Newman, 2000), they do not know which behavior is correct to reach the desired future state and what the latter is, as a matter of fact.

Hence, due to their unclear vision for the future and operational embeddedness, organizations experience shortsightedness in planning the future. Moreover, small organizations import more instability from the transition environment than large organizations due to insufficient resources and lack of organizational slack. Establishing legitimacy by matching to the requirements of the evaluating audiences in such environments is a very challenging endeavor simply because these standards are not well-defined. For small organizations, gaining legitimacy is even more challenging since they face a combination of liabilities or discounts that the evaluating audiences place on them due to their small size, being new to the market and the context, in which they operate.

But before, we engage into this discussion, we have to look at which organizations are considered small- and medium-size enterprises (SMEs) and what the specificities of small businesses in transition environments are.

4. SMEs in Transition Environments

Small enterprises are the most common type of enterprises (Soriano & Dobon, 2009). Thus far, in the literature, there is no commonly-agreed upon definition of what constitutes an SME. Moreover, across countries different criteria are adopted, such as number of employees, sales turnover and value of assets on the balance sheet (Ayyagari *et al.,* 2007). Even when the same criterion is used, the definition of an SME varies from country to country – i.e., in Egypt the SMEs are the enterprises that have up to 50 employees while in Vietnam, the threshold level is set at 300 employees (Dalberg Report, 2011). These different classification systems make the cross-country comparison as well as identifying trends related to the development of the SME sector very difficult (Newberry, 2006).

This is the reason why the European Union has adopted one unified definition which applies across all member countries (McIntyre, 2003). According to this definition, the SMEs are enterprises that have less than 250 employees, sales turnover of less than €50 mn, and balance sheet total of less than €43 mn. According to this definition, the SMEs include the micro-enterprises (less than 10 employees), small enterprises (less than 50 employees) and medium enterprises (less than 250 employees) (McIntyre, 2003) (see Table 1).

Criterion	Headcount	Sales turnover	Balance sheet total
Micro	< 250	≤ €50	≤ €43
Small	< 50	≤ €10	≤ €10
Medium	< 10	≤ €2	≤ €2

Table 1: EU definition of SMEs (Dalberg Report, 2011)

The SMEs evolving in transition contexts are more prone to import instability from the environment (Smallbone *et al.,* 1999) due to their small size, insufficient resources and lack of organizational slack which can be used to absorb the external pressures. The small size makes the SMEs very vulnerable to the changes in the external environment and if they do not develop flexibility to react to the dynamic shifts in the environment, their mere survival will be threatened.

Along with the process of transition, small organizations are exposed to another process – the process of globalization. It represents not only a constraint (increased competition) but also important growth opportunities for them.

5. Globalization and SMEs from Transition Environments

Globalization is the "growing interdependence of national economies" including the consumers, suppliers, producers, governments in different countries (Knight, 2000). While globalization represents a source of opportunities, it is also a source of complexity for all organizations – from multi-national enterprises (MNEs) to SMEs (including family businesses) (Ivanova & Castellano, 2011). It affects the way organizations consider their environment. Indeed, based on the process of globalization, more organizations consider an additional environmental layer, which represents the global markets (see Fig. 2). Hence, they can no longer act only at their local and national layer but more often consider the international and global layers for their activities.

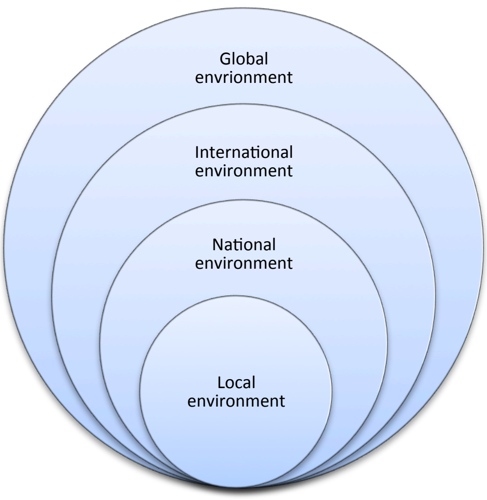

Fig. 2: Layers of the Organizational Environment

As a result, globalization is associated with increased diversity – for the activities of an organization (geographic diversification) (Dess & Beard, 1984) as well as the variety of actors that an enterprise can interact with at the different environmental layers (Scott & Meyer, 1991). This diversity is a source of uncertainty and complexity for the organizations (Lawless & Finch, 1989).

For a very long period, globalization was associated with large, mature and integrated organizations (Oviatt & McDougall, 2005). Large size as a source of numerous advantages (the most important of which being the economies of scale) was considered as a necessary requirement for multinationality (Oviatt & McDougall, 2005). However, in today's environment, MNEs are not the only type of organizations that can find advantages based on the globalizing markets. International markets represent an important opportunity for growth even for small enterprises (Lu & Beamish, 2001).

The small global firms are SMEs that cross the boundaries of their country of origin in order to conduct business in the international environment (Ivanova & Castellano, 2011). Small global firms achieve foreign market presence mainly through exporting and/or foreign direct investment (FDI) (Dimitratos *et al.,* 2003). The reasons why SMEs look to externalize their activities are numerous – home market maturation (Oviatt and McDougall 2005), competitive pressures (Ivanova & Castellano, 2011), higher return on investment, especially for technologically intensive industries (Yamakawa *et al.,* 2008), new markets for distinctive products/services (Ivanova & Castellano, 2011).

Therefore, from one side the SMEs in transition environments face the uncertainty of the local context. On the other side, there is the complexity along with new opportunities associated with the process of globalization. The literature so far has focused mainly on the challenges faced by large companies trying to externalize their activities. Less is known about how SMEs cope with the process of globalization. Thus, the question is: *what are the specific legitimacy challenges that small enterprises in transition contexts face when they try to access international/global markets?* This question is part of the larger question: *what are the barriers for growth for SMEs in transition environments?*

Since we perceive the process of internationalization as a process in which the organizations access a different environmental layer – from national to international and/or global, we look at the assessment that different groups of stakeholders provide for the organization at the different layers. The potential discount that an evaluating group of stakeholders (clients, partners, suppliers, employees, governments, etc.) can place on an organization in comparison to their competitors is called *liability*. Organizations experiencing liability are in a disadvantageous position in comparison to their competitors because their legitimacy is threatened, which consequently may impact their long-term survival chances. Hence, the legitimacy challenges of organizations are determined by the liabilities experienced by them. In the section below, we present the different types of liabilities faced by the SMEs in transition contexts and their respective components.

6. Legitimacy Challenges for SMEs in Transition Environments

The legitimacy challenges experienced by SMEs in transition environments are associated with the discount that their international and/or domestic partners may place on them due to certain organizational characteristics (i.e., age, size) or due to the particular context in which they operate or are willing to access. Liabilities undermine the legitimacy of organizations which threatens their mere survival. Hence, overcoming them is very important for any organization willing to ensure its long-term existence. The liabilities experienced by the SMEs evolving in transition context can be classified in three main groups– *liability of origin* (Bartlett & Ghoshal, 2000), *liability of smallness* (Freeman *et al.,* 1983) and *liability of foreignness* (Zaheer, 1995).

a. Liability of origin

The term *liability of origin* was coined by Bartlett & Ghoshal (2000). It refers to the discount that an evaluating audience can place on a company based on its context of origin (Ivanova & Castellano, 2011). The concept relates to the economic and socio-political aspects of the transition environment characterized by high level of risk for all actors. The *liability of origin* will vary from country to country. It is directly linked to the level of institutionalization of the environment or the extent to which the market-based institutions have been developed, established and accepted. The higher the level of institutionalization of the market-based institutions, the lower the uncertainty and instability of the local environment. This corresponds to lower level of *liability of origin*.

As it was mentioned earlier, the transition environments go through a shift from one institutional framework to another one during which the institutions associated with the old model slowly fade away and are substituted by new institutions. This profound change includes structural reforms – opening to capital markets, freedom to enterprise, and privatization of formally state-owned enterprises (SOEs) (in economies shifting from centrally-planned to open market) as well as macro-economic stabilization - tight monetary and fiscal policy (De Larosiere, 2001). Even though the governments of emerging economies try to manage the structural and macroeconomic reforms, economic and political shocks are not rare occurrences (Hoskisson *et al.,* 2000). These shocks augment the uncertainty for both the domestic and foreign firms (Hoskisson *et al.,* 2000).

The lack of well-established market institutions impedes the efforts of the SMEs from transition contexts to internationalize – i.e. banks in many emerging economies have limited information, skills, regulatory support to engage in lending to SMEs (Dalberg Report, 2011), which impacts the ability of small business to access foreign markets. In addition, foreign investors shy away from investing in SMEs in emerging economies because of the higher level of risk.

Even though governments in many countries are putting the effort to encourage the development of the SME sector, the institutions supporting the development programs are often not well-established. In example, a French company can rely on the support of the Missions economiques which are part of the French Ministry of Economy, Finance and Industry. These organizations provide commercial counseling services for French companies in more than 113 countries in the world. In comparison, a Bulgarian company will rarely rely on the local public administration or its sub-divisions worldwide for help in terms of providing information regarding different markets and/or foreign business opportunities. There are several reasons for this: the Bulgarian SMEs perceive the government agencies as being inefficient and unreliable in providing information on foreign markets. They may also lack information on what the government agencies can indeed provide; and/or lack of social networks with government officials, which will prohibit them from trying to access the information available, etc. All of these reasons are indeed associated with the lower level of development of the institutions in transition contexts, where their role is not clearly defined, and/or even if it is, it has not been fully operationalized.

It is important to mention that different country markets will be at a different stage of the transition process (see Fig. 1). Hence, the level of institutionalization of each country market will be different. The latter will directly influence the liability of origin. Therefore, we can state:

Proposition 1: The level of institutionalization of the environment will determine the intensity of the liability of origin – the higher the level of institutionalization, the lower the liability of origin.

b. Liability of foreignness

The *liability of foreignness* is associated with the disadvantageous position a company might face (in comparison to local competitors) when it tries to access international markets which it is not familiar with (Zaheer, 1995; Kostova & Zaheer, 1999). According to some authors, the key driver behind the *liability of foreignness* is the institutional distance (regulatory, normative and cognitive) between the home and the foreign country market (Eden & Miller, 2004).

The *liability of foreignness* is indeed the additional costs that a foreign company will incur in a particular market that a local company does not bear (Zaheer, 1995). These costs are due to the unfamiliarity with the local context based on lack of knowledge about the market and/or lack of experience (competencies) in doing business in an environment, which is different from the home base. *Liability of foreignness* can severely impede the international expansion of a firm. It is not experienced only by SMEs evolving in transition environments but by all enterprises trying to externalize their activities. The problem might be more severe for SMEs in transition contexts since they have a limited access to resources (financial, managerial, informational, etc.) due to their small size as well as highly unstable local environment.

c. Liability of smallness

Small organizations experience *liability of smallness* (Freeman *et al.,* 1983). As a result, they have higher chances of failure (Freeman *et al.,* 1983) due to fewer resources, less well-trained managers, and less developed relationships with creditors (Bruderl & Schussler, 1990) and other external stakeholders (Singh *et al*., 1986). In transition environments, small organizations are even more vulnerable since they import easily instability from the environment (Smallbone *et al.,* 1999).

The *liability of smallness* is directly associated with the limited access to resources and capabilities – financial, physical, managerial, informational, etc. (Zhu *et al.,* 2007). As a result, SMEs going global are less resource-endowed and less competitive (Zhu *et al.,* 2007). In example, one of the biggest problems that SMEs in emerging economies face is lack of financing. According to the Dalberg Report (2011), the financing gap for SMEs in emerging economies is between US$ 700-850 billion. Around 43% of the small enterprises in these markets report access to financing being their major constraint to growth while the number is 11% for the SMEs in developed economies (Dalberg Report, 2011).

In addition, SMEs in emerging economies experience lack of informational resources. In fact, the lack of efficient information and know-how related to the foreign markets is one of the most important problems SMEs face when they expand internationally (Liesch & Knight, 1999). Limited information may hinder the ability of small firms to identify and act upon entrepreneurial opportunities in foreign markets (Zhu *et al.,* 2007). Moreover, the information generated in the transition contexts even from official (government-related) sources is often not reliable.

Also, due to their small size, SMEs have less collective managerial experience and business expertise than large companies (Newberry, 2006). The strategic orientation of the whole company is often a reflection of the mindset of the founding team members. Hence, the decision to internationalize can be impeded based on the limited collective managerial experience within the company.

The *liabilities of smallness* and *foreignness* have been widely studied in the literature (Freeman, *et al.,* 1983; Zaheer, 1995; Kostova & Zaheer, 1999). These liabilities are not only typical for organizations coming from transition environments but also for SMEs coming from developed economies. The specificities for SMEs evolving in transition contexts come from the interaction between the three types of liabilities – *smallness* (associated with the lack of resources), *foreignness* (related to the unfamiliarity with the foreign business environment) and *origin* (associated with the instability of the environment in which they are based). The interaction between the three liabilities makes the process of internationalization of their activities a very challenging endeavor (see Fig. 3).

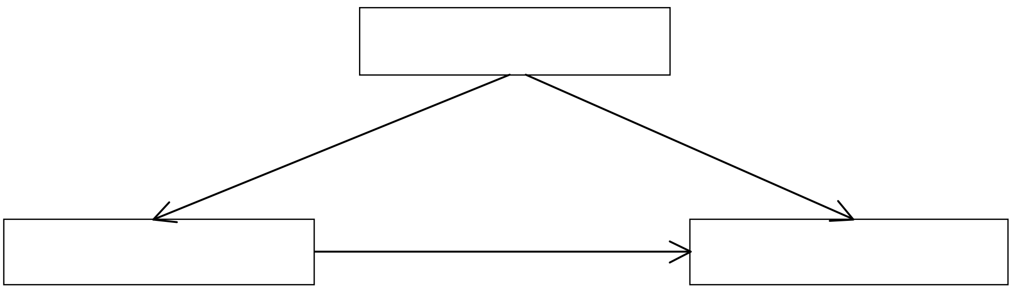

Fig. 3: Interaction between Organizational Liabilities of SMEs in Transition Environments

The liability of origin which is directly linked to the level of institutionalization of the environment will influence the intensity of the liability of foreignness and liability of smallness. In example, if a small business wants to externalize their activities but they lack the appropriate resources (managerial, informational, etc.), the lower level of institutionalization of the environment will make it even more difficult to access the necessary resources – such as financing, highly qualified labor, or appropriate information. As it was mentioned earlier, the financing gap faced by SMEs in emerging markets is much more severe than the one experienced by small businesses in the developed countries.

Therefore, we state:

Proposition 2: The higher the level of liability of origin, the higher the intensity of the liability of smallness.

Proposition 3: The higher the level of liability of origin, the higher the intensity of the liability of foreignness.

In addition, small size and the consequent lower level of resources inhibit the attempt to internationalize – i.e., the mere fact that a small business may not have people that speak foreign languages may already impact the way the company considers the international expansion of its activities. Lack of appropriate information on foreign markets, limited collective managerial experience, less developed relationships with government officials may all be considered as factors that constrain the internationalization of small enterprises.

Hence, we hypothesize:

Proposition 4: The higher the liability of smallness, the higher the intensity of liability of foreignness.

Nevertheless, some SMEs from emerging economies successfully engage in internationalization activities. The internationalization efforts will depend on the sector which will determine how reliant on the local context the company is as well as the level of institutionalization of the transition context. In general, the lower level of dependence on the local context (i.e., high tech sectors) and the higher level of institutionalization will act favorably in the attempts of local SMEs to internationalize.

Since the experienced liabilities impact the survival chances of SMEs operating in transition contexts and trying to access the international/global markets, overcoming them is crucial in order to ensure their continued existence and growth. In the section below, we discuss some possible ways to overcome the organizational liabilities (or legitimacy challenges) experienced by small enterprises in transition environments.

7. Ways to Overcome the Challenges faced by SMEs in Transition Environments

There are two main approaches that can be adopted to treat the liabilities faced by SMEs in transition environment – individual company approach and public policy. In addition, there are private enterprises that have been created in different parts of the world in order to meet the needs and bridge the resource gap experienced by many small businesses in emerging markets.

a. Individual-company level

On an individual company level, Ivanova & Castellano (2011) present the opportunity to address the liabilities faced by SMEs in the international business environment by adopting valid signals of legitimacy[3]. The valid signals of legitimacy are organizational characteristics (which represent resources and/or competencies) that can be used in order to signal the adherence to the expectations of different evaluating audiences. The valid signals of legitimacy are observable, hard to imitate and have to have shared meaning between the sending and the receiving party (Ivanova & Castellano, 2011). Based on them, the evaluating audiences grant organizational legitimacy meaning that the organization is understood, its business practices meaningful and acceptable. Some examples of valid signals of legitimacy include: internationally-recognized standards, such as ISO 90001, quality awards from international fairs, partnerships with global players (i.e., Microsoft, Oracle, etc. in the IT sector). SMEs from transition environments that adopt valid signals of legitimacy recognizable by the evaluating audiences residing at the environmental layer which they aim to access can indeed enhance the success of their internationalization efforts in the short run and their survival chances in the long run

In addition, enterprises from one sector may try to self-organize themselves in order to promote the sector altogether. Examples include the creation of cluster organizations, which disseminate industry information, lobby with the government, consult the public

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[3] Organizational legitimacy is the perception that an organization adheres to the evaluating audiences' requirements and expectations. It is achieved based on the use of valid signals of legitimacy (Ivanova & Castellano, 2011).

administration regarding the policies adopted that may have a direct impact on the sector, provide legal, accounting and other specialized services to the member companies, etc. Overall, the goal of such organizations is to increase the competitiveness of the sector and all member companies. These efforts are often directly associated with the liability of origin and the active participation of companies in self-organizing activities lead to its decrease. Consequently, companies improve their success chances when trying to access international/global markets.

b. Public policy

More and more governments, regional and world institutions recognize the importance of small enterprises as engines that spur economic growth (Stein *et al.,* 2010). This is particularly evident in emerging economies, where they represent approximately 45% of the employment and 33% of the GDP (Stein *et al.,* 2010). Public policy initiatives have been created all over the world to stimulate the development of the SME sector. These initiatives can be grouped in two main categories – 1) developing programs aiming at making the context more favorable for the business activities of the SMEs, and 2) policies that directly help SMEs overcome the financial constraints – access to financing being the most important resource challenge. These two groups of initiatives are often interlinked; their goal is to stimulate the creation, growth and development of small enterprises.

Regarding the first aspect – making the context more favorable - the European Commission launched in 2008 in all Member States, the Small Business Act (SBA) comprised of concrete measures in some 10 principle areas aimed at supporting the SMEs and helping them maintain and/or regain their competitiveness (European Commission Annual Report on EU SMEs, 2009). One aspect of the SBA is directly linked to the internationalization efforts of SMEs – its goal is to help SMEs benefit more from the opportunities of the Single Market as well as the growth in other markets. The SBA also treats the regulative and administrative barriers faced by the SMEs. And while all organizations may be confronted with some sort of legal barriers, the problem is more severe for the SMEs in transition contexts since they have limited human and financial resources (Newberry 2006).

Regarding the second aspect – enhancing the access to financing - the national governments in many countries (South Korea, Chile, Malaysia and other) adopted a policy to extend credit guarantees to support lending to SMEs that would otherwise go unserved (Stein *et al.,* 2010). Other initiatives include regulatory and legal steps, such as increasing access to collateral by reducing the barriers to property registry, improving the quality of financial information about SMEs – i.e., by developing credit bureaus (Stein *et al.,* 2010).

Moreover, government agencies can help individual companies increase their competitiveness in international/global markets by stimulating them to adopt valid signals of legitimacy. An example of such initiative is the European Software Institute created with the aim of promoting a process standard, called Capability Maturity Model Integration (CMMI) in the IT sector. One of the main purposes of this institute is to disseminate information and assist small IT firms in adopting the CMMI standard. As any standard recognized at a global level, CMMI can be perceived as a valid signal of legitimacy that can help companies communicate their adherence to some (process in the case) standards which can consequently enhance the marketability of their products/services.

The liabilities (which are directly linked to the resource gaps) experienced by SMEs in transition environments lead to the development and the growth of private enterprises that consult and help the latter in their activities, including their internationalization efforts. Very often, the main purpose of these firms is to redirect financing in order to stimulate the development of small enterprises. An example of such organization is *Business Partners* based in South Africa. The company provides not only financing to young African entrepreneurs and small businesses but also sectorial knowledge and other value-added services (property management, mentoring, consulting).

8. Conclusion

SMEs in transition environments face a particular set of legitimacy challenges when they try to access the international/global markets. The specificity comes from the interaction between three types of organizational liabilities – origin, foreignness and smallness. Since internationalization represents an essential way for small businesses to grow, overcoming the above-mentioned liabilities is an important task not only for individual companies but also for local and regional governments, as well as international institutions (EU, World Bank, IMF). By overcoming these organizational liabilities, small enterprises enhance their legitimacy, or they demonstrate that they meet the requirements and expectations of different stakeholder groups. The latter increases their survival chances in the long run.

The limitations of the study lie in the fact that this is just a conceptual exploration on organizational liabilities experienced by small enterprises in transition environments and the interaction among them. Future studies can further explore the interaction between the different types of liabilities and test the above-developed propositions. In addition, future research can also examine the relationship between liabilities and legitimacy. It is possible that certain types of liabilities make organizations seek certain types of legitimacy.

The question of organizational liabilities and its relationship to the legitimacy concept is directly related to the barriers to growth. Studying them can help individual companies and public policy administrators adopt the necessary strategies in order to ensure future growth and prosperity of the SMEs within a particular country and/or region.

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