

**EXPLAINING THE IMPACT OF SMEs' INTERNATIONAL SCOPE ON
PERFORMANCE: A CONTINGENCY PERSPECTIVE.**

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Abstract

Despite the amount of research on SMEs internationalization, the debate about the relationship between the SMEs' international diversity and performance remains open. In this paper we try to contribute to this debate by focusing on three moderating influences: (1) the impact of managerial characteristics as indicators of the managerial resources that sustain SMEs' entrepreneurial actions; (2) the effects of adopting different types of strategic orientation to escort the internationalization strategy; and (3) the interaction between the number of foreign markets and the relative importance of foreign sales. Our results show an inverted U-shape relationship between international scope (number of countries) and performance of SMEs, and that the characteristics and strategic postures of the managerial team moderate this relationship. SMEs' performance benefits more from international diversification when the managerial teams show a higher proactive behavior, hold previous experience in other firms or markets, and are less controlled by owner-family members. These characteristics provide SMEs with better skills and capacity to cope with increasing complexity of foreign markets.

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Introduction

The trends of globalization of economic activity and increase of international competition in most industries are raising the importance of international diversification for both small and large firms. Within this context, small and medium-sized enterprises (SMEs) have significantly increased their presence in the international arena during the last years (Oviatt and McDougall, 1999), and this trend can be expected to continue in the next future as a consequence of the growing integration of the world economy and the declination of trade-barriers among countries (Lu and Beamish, 2001).

As a consequence of the growth of SMEs' internationalization phenomenon, researchers from the entrepreneurship, strategic management, and international business areas have recently addressed the antecedents, processes and effects of SMEs internationalization (Lu and Beamish, 2006). However, although existing research has provided important advances in our understanding of the antecedents and processes of SMEs internationalization, the debate about the relationship between the SMEs' international diversification and performance remains open. In fact, even if more than a hundred investigations of the linkage between firms internationalization and performance have been undertaken worldwide, the findings of this research stream have been inconclusive and contradictory (Ruigrok et al., 2007; Bausch and Krist, 2007). Moreover, in the specific case of SMEs our knowledge about this relationship is still poorer because most studies have been focused on large firms, and their results may not necessarily apply to SMEs (Lu and Beamish, 2006).

Furthermore, the relationship between international diversification and performance is context-dependent (Chakrabarti et al., 2007; Wright et al., 2007). This relationship may exist just under certain conditions, and moderators that produce differential internationalization-performance effects may be different between SMEs and large firms (Bausch and Krist, 2007). On the one hand, smaller firms have more limited resources than large firms to cope with the risks and complexities of foreign expansion (Morgan and Katsikeas, 1997). SMEs lack the amount of slack resources and hierarchical administrative systems that can help larger companies to manage complex decision-making processes (Lubatkin et al., 2006), such as those involved in the internationalization of the firms, and consequently SMEs need to rely more on the abilities of their managers. In this sense, managerial capabilities become a key issue on the impact of internationalization of SMEs on performance (Singh et al., 2009) and, consequently, studies focused on the effects of SMEs international diversity should take into account the role and characteristics of managers, who are the main responsible for the related decision making and implementation processes (Tihanyi et al., 2000; Herrmann and Datta, 2005). The Upper Echelons (UE) perspective articulated by Hambrick and Mason (1984) provides a framework within which the role of top managers in influencing organizational outcomes can be interpreted.

On the other hand, as any entrepreneurial strategy (Lu and Beamish, 2001), the success of internationalization requires the simultaneous adoption of certain strategic postures and organizational changes that may help to enhance firm performance (McDougall and Oviatt, 1996). Decisions regarding international expansion imply a high level of uncertainty as the firms enter physically or culturally distant markets or become more dependent on revenues generated in markets different from the more familiar domestic market (De Clercq et al., 2005). Recently, researchers from the

Strategic Entrepreneurship perspective have tried to identify the different strategic postures that firms adopt to face the environmental challenges. They suggest the need for firms to combine entrepreneurial attitudes and strategic thinking to identify and exploit new opportunities and to make decisions in order to achieve and maintain competitive advantages and earn above-average returns (Kuratko and Audretsch, 2009). Entrepreneurial actions entail creating new resources or combining existing ones in new ways to develop new products or enter new markets before competitors, whereas strategic management entails the set of decisions and actions designed to achieve and sustain competitive advantages (Ireland et al., 2001). So, we posit that considering the Strategic Orientation (SO) adopted by the SMEs, which is a combination of entrepreneurial and strategic attitudes impelled by the managerial team, may contribute or limit the impact of international diversification on performance.

Finally, the decision of diversifying the firms' international scope under certain environmental contexts may have a different impact on the firms' performance in SMEs than in larger organizations. For example, large firms competing in mature or low munificent environments can achieve good performance levels without entering new markets because they can take advantage of size and scale economies in the home market. However, SMEs may opt for internationalization in order to escape from intense competition contexts and explore new opportunities for growth and profitability in the international markets (Wan and Hoskisson, 2003; Wright et al., 2007).

In this paper we try to contribute to the debate regarding the linkage between SMEs' international diversification and performance, which is an important issue because managers are concerned with whether entrepreneurial initiatives, such as the firm's international diversification, can lead to higher performance and how their firms can become more competitive when expanding geographically. We aim to achieve a

better understanding of this phenomenon by focusing on three moderating influences: (1) the impact of managerial characteristics as indicators of the managerial resources and capabilities that sustain SMEs' decisions and actions; (2) the effects of adopting different types of strategic orientation to escort the internationalization strategy, and (3) the combination of high number of foreign markets and high level of foreign sales. We contextualize our study on low munificent environments in order to control for the potential effect of industrial contingencies.

We elaborate our arguments employing the literature on Geographical Diversification (Lu and Beamish, 2006; Tallman and Li, 1996), Upper Echelons theory (Finkelstein, Hambrick and Canella, 2009; Hambrick and Mason, 1984), Strategic Entrepreneurship (Ireland et al., 2003, Kuratko and Audretsch, 2009) and Contingency Perspective (Zahra and Covin, 1995).

In the following sections, we first introduce the theoretical framework and develop the hypotheses focused on the relationship existing between the international diversity and performance of SMEs, as well as on the factors that moderate this linkage. Then, we describe the methodology used for the empirical analysis, the measurement of dependent, independent and moderating variables and we discuss the main results of our study. The paper concludes by addressing implications for research and practice.

Theoretical framework

International diversification and performance

The view that internationalized firms report higher levels of performance than domestic ones is widely assumed among most researchers and practitioners (Wright et al., 2007), however the empirical evidence on the relationship between internationalization and firm performance has been mixed (Ruigrok et al., 2007).

Internationalization provides firms the possibility of achieving larger volume of production, leveraging their resources and core competences across a broader range of markets, capitalize on market imperfections or location advantages, or even finding new market or learning opportunities (Glaum and Oesterle, 2007). International expansion represents an important source of new opportunities, and exploiting those opportunities is a significant source of performance improving. In fact, geographic expansion is one of the most important paths for firm growth and achievement of higher returns on their resources, in particular for SMEs, which tend to pursue international strategies to leverage their core competences across a broader range of markets (Lu and Beamish, 2006).

Internationalization has also potential negative consequences derived from costs related to the distance, coordination and control, to the unfamiliarity of the company with the local idiosyncrasies, costs of learning about the new international context, or increased risk, among others (Lu and Beamish, 2001; Contractor et al, 2007).

As internationalization may provoke both positive and negative impacts on firms' performance, research has focused on explaining the shape of the relationship: linear; U-Shaped; inverted U-Shaped; or S-shaped (Ruigrok et al, 2007; Contractor et al., 2007). Researchers proposing a linear relationship suggest that as firms expand internationally, there is a positive impact on performance (Tallman and Li, 1996). Recently, this research stream has emphasized the fact that this linear relationship is moderated by other factors (Kotabe et al., 2002). Other researchers have hypothesized a U-shaped relationship (Ruigrok and Wagner, 2003), suggesting that firms initially experience negative performance as a consequence of the unfamiliarity with the new context and that performance increases as the firms learn to operate in new markets. The third stream of research (Geringer et al., 1989; Gomes and Ramaswamy, 1999) argues

that there is a curvilinear relationship, but that it has an inverted U-shape because over time the positive impact on performance is outweighed by the costs of coordinating and controlling operations increasingly dispersed. Finally, the most recent literature suggests the existence of a three-stage relationship (horizontal S-shaped), arguing that performance is negatively influenced in the initial stage of early internationalization, as well as in a third stage wherein some firms may over-internationalize (Contractor et al., 2007).

The majority of these studies use the ratio of foreign sales to total sales (FSTS) to measure the degree of internationalization of the firms. Though FSTS can be objectively measured and thus easily replicable, it only captures a part of the multinational phenomenon (Li, 2007). We consider that the complexity of operating internationally is more closely related to the number of host countries in which the firm operates than to the FSTS ratio. In this sense, while the extent of internationalization (FSTS) focuses on the overall strategic importance of foreign operations to the firm, it does not address the breadth or scope of foreign operations. A different approach to international diversity is to select a measure of the breadth or scope of international operations as a determinant of performance. Compared to multinationality ratios measures, the geographical scope of international operations addresses the ability to arbitrage operations across countries and leverage location-based advantages (Tallman and Li, 1996).

The distinction between extent and scope on internationalization is important because these measures may have different implications on the shape of the relationship between international diversification and performance. Some previous studies assume that initial stages of low performance (as proposed by U-shaped and horizontal S-Shaped streams of research) are associated to the firms' lack of international experience

and knowledge about the structure of the foreign markets (Ruigrok and Wagner, 2003; Contractor et al. 2007). So, it is somehow assumed that a low degree of internationalization indicates that a firm is in its early and first steps in the international arena. Although most of the times this can be true, some firms with a low percentage of FSTS may hold a significant experience and knowledge regarding a certain foreign market in which they could have maintained regular international operations for a long time. This circumstance may be especially feasible in the case of SMEs, which could have started their internationalization a long time ago but, given their organizational, financial and managerial constraints to coordinate and control foreign activities, preferred to operate just in a few number of host countries and not to overweight the importance of foreign markets respect their total sales.

According to these arguments we posit that, at low (or initial) degrees of international scope, SMEs will have the possibility of complementing their domestic markets, providing new avenues for growth and profitability. As they gain international experience they will also have the opportunity to understand and learn about the international best practices, and about competitors' strategies, which is likely to be beneficial not just in their future internationalization activities, but also in their domestic operations (Singh et al, 2009). Thus, as the firms expand their geographic scope, the benefits of internationalization are likely to have a positive impact on performance of SMEs.

While the gains of international scope are likely to increase over time, the costs may also rise at a faster rate. A broad scope of operations entails costs derived from institutional and cultural barriers to the transfer of competitive advantages among countries, as well as from the difficulties of tailoring activities to serve a particular target segment or market (Geringer et al, 1989). At a certain level of international diversity, the costs of complexity stemming from coordinating, integrating and

monitoring foreign operations scattered across a higher number of countries can reach a significant level, and the managerial and resource constraints of SMEs may limit their capacity to manage these complexities.

So, our first hypothesis suggests that:

Hypothesis 1: The relationship between international diversity and SME performance exhibits an inverted U-shaped curve

Moderating influences

Strategic Orientation

Differences in SMEs' international geographic reach (scope of internationalization) might be attributed to the processes adopted by them to make decisions and to face opportunities and threats associated with international expansion (George et al., 2005; Acedo and Florin, 2006). For examples, firms that show a proactive Strategic Orientation (SO) usually emphasize effective information seeking and identification of relevant information for decision-making. These firms are also expected to exhibit higher levels of risk tolerance in ambiguous situations such as those involved in internationalization (Sapienza et al., 2005; Knight, 2001). Moreover, firms with proactive SOs are likely to develop product and process innovations and, thus, such firms have an important knowledge base that allows them to pursue fast and risky routes to grow and to diversify towards a wider range of markets and businesses (Tihanyi et al., 2000).

Since firms with a highly proactive orientation are willing to undertake risky decisions (Miller, 1983), they may more readily accept the uncertainty embedded in further increasing cross-border activity. These firms are in a better position to take advantage of foreign opportunities and may also increase the firm's potential to leverage

the knowledge gained from its prior screening activities and its existing capabilities by entering new markets (De Clercq et al., 2005).

Therefore, firms with proactive SOs will show more aggressive and active attitudes towards foreign markets, favoring the firms' process of consolidation abroad in terms of the scope of their foreign markets (Pla-Barber and Escribá-Esteve, 2006; De Clercq et al., 2005). However, firms with more defensive SOs will have a less visible effect on their international consolidation (Sapienza et al., 2005). Consequently, we hypothesize that:

Hypothesis 2: Performance should vary positively with the interaction of strategic orientation and level of international scope

TMT Characteristics

Research has consistently pointed to management as the principal force behind the initiation, development, sustenance and success of SME internationalization because of the direct responsibility for, and involvement in, the decisions of the firm (e.g. Carpenter and Fredrickson, 2001; Hambrick, Cho and Chen, 1996; Herrmann and Datta 2005; Sanders and Carpenter, 1998). For SMEs, decision-making power is generally concentrated in the hands of one or very few persons, and therefore international strategy decisions are inclined to be the direct responsibility of the owner manager or senior management team (Reid, 1981). Moreover, it is argued that the performance of SMEs in international markets is not only a function of the accessibility of resources, but also of managerial competence (Chandler and Hanks, 1994). Therefore, considering the executive characteristics that may influence the capability threshold of the managerial team will contribute to understand the moderating effect of the SMEs' managers on the international diversity - performance relationship.

Although many TMT characteristics might prove worthwhile, our theoretical focus is restricted here by TMT level of education, TMT previous experiences and number of family members in the team. This is because a firm's internationalization increases information processing demands, but also increases the need for more specialized knowledge in the TMT when the firm extends into foreign markets and operations (Sanders and Carpenter 1998). The managers' information-processing capacity depends on their skill sets and breadth of profession (Carpenter and Fredrickson 2001). Thus, we consider that analyzing the TMT's educational level and previous experiences may be advantageous to understand the impact of SMEs internationalization on performance.

Finally, we also consider the involvement of family members in the firm management. Family firms are usually more risk-averse than non family firms (Zahra et al., 2004). So, while the involvement of family members in the managerial team may produce a higher cohesion and shared strategic cognition, the higher risk aversion of family managers can limit the perception of the potential benefits of internationalization strategies. Moreover, when decision-making processes are controlled by family members other team may feel constrained to speaking out and questioning ideas, which makes more difficult exploring new opportunities in other markets or businesses.

TMT's Level of education

The level of education of a firm's top managers is closely related to the individuals' knowledge and skill base (Hambrick and Mason, 1984). Executives with a high level of education have cognitive abilities and qualities to process information and to execute more complex decision-making to manage ill-structured situations (Papadakis and Barwise, 2002). They also can discriminate between a more extensive

variety of alternatives to understand environmental and organizational problems and, therefore, to devise more appropriate responses to complex situations, such as those involved in the internationalization process (Wiersema and Bantel, 1992; Herrmann and Datta, 2005; Wally and Becerra, 2001). Furthermore, a higher level of education has been associated with values and lifestyles that might encourage more open-mindedness towards different cultures (Tihanyi et al., 2000), greater tolerance for ambiguity and greater openness to change and innovation. In general, we would thus expect TMTs with a higher average educational level to have a greater interest in strategies such as internationalization

Education offers opportunities for gaining knowledge about foreign countries, including their different markets and cultures. Therefore, higher levels of education and their associated greater socio-cognitive capacity should enable managerial teams not only to transcend ethnocentrism in their approaches to strategic decision making but also to choose the right markets and entry options to increase gains. Our hypothesis suggests that the interaction of international diversity and level of education in TMTs will have a positive effect on performance levels.

Hypothesis 3: Performance should vary positively with the interaction of TMT's educational level and level of international scope

TMT's Previous experiences

The previous experience that managers accrued by working in other firms, industries or markets is linked to more innovative ideas and to the breadth and variety of perspectives that managers hold within the organization (Finkelstein and Hambrick, 1990). Teams that include managers with experience in other firms or markets have a wider vision of strategic decisions, make use of a higher variety of information sources

and have differentiated capabilities (Lee and Park, 2006). Therefore, they tend to make more changes in structure, procedures and people compared to teams whose members have been promoted from within the firm (Hatum and Pettigrew, 2006). In fact, managers who have developed their careers exclusively in one organization can be assumed to have relatively limited perspectives when faced with an unprecedented problem or environmental changes (Hermann and Datta, 2006).

Geographical scope of international activities brings more governance complexities and higher information processing requirements for the managers (Reuber and Fischer, 1997; 2002). Therefore, SMEs with experienced TMTs may find it easier to manage the complexity of geographical scope and may help in achieving better synergies in operations across different countries, enhancing the gains from geographical diversification (Athanassiou and Nigh, 2000). Therefore, the combination of international scope and TMTs characterized by higher levels of experience from outside should improve performance levels of SMEs.

Hypothesis 4: Performance should vary positively with the interaction of TMT's experience and level of international scope

Family-owner membership

Family firms generally dominate the economic landscape, especially in the case of SMEs. Consequently, the presence and participation of members from the owner-family in the managerial processes needs to be considered into the Upper Echelons perspective (Chrisman et al., 2005).

Ensley and Pearson (2005) stated that the type and degree of involvement of family members affect how the managers process information and the dynamics of interaction within the team. However, there is no consensus about its specific influence

on the processes, attitudes and values of the managerial team. These authors found that while the involvement of family members in the firm management enhances TMT cohesion and shared strategic cognition, it also may constrain other team members from speaking out and questioning ideas.

Some other researchers consider that heterogeneity and a broad managerial mindset are important factors that foster the ability to create and support ideas (Hatun and Pettigrew, 2004). Therefore, the contribution of professional managers in the team may provide aggressiveness, analytical and risk assessment skills to the firm, which are capabilities and expertise needed in hostile environments (Nordqvist, 2005). By incorporating non-family managers, SMEs may raise their levels of heterogeneity and professionalism in the managerial team; foster a culture of external orientation and increase the chance of conflict of ideas, innovation and entrepreneurship (Zahra et al., 2004).

But family-SMEs face capital and managerial constraints because of ownership and control structures that may reduce their ability and willingness to attract professional managers (Carney, 2005). Founding families that control the decision-making processes and dominate the organization for years may increase the likelihood of an inward focus and limit the exploration of innovative ideas (Zahra et al., 2004). The need to satisfy both family and business interests simultaneously creates conflicts of interest that may be detrimental to the firm.

Although some authors have argued that the entrepreneurial activity is a common characteristic of many family firms (Zahra et al., 2004), their tendency to take risks in a lesser extent than do nonfamily firms (Naldi et al., 2007) may limit their to engage in international activities.

Therefore, we expect that the involvement of family-owners in the managerial team may constrain the disposition of SMEs internationalize their operations and may limit their access the resources and capabilities needed for the internationalization process (Fernandez and Nieto, 2006). Thus, these characteristics will limit the potential benefits of internationalization strategies over performance levels.

Hypothesis 5: Performance should vary negatively with the interaction of family members in TMTs and level of international scope.

International scale

The extent of internationalization, usually measured as the ratio of sales from foreign operations to the total sales of a firm (FSTS), indicates the strategic importance of international activity for the firm. The larger volumes of sales and production made possible by internationalizing enable firms to achieve economies of scale and increase labor productivity and management efficiency (Kogut, 1985). Such experience curve economies lead to substantial cost savings and contribute directly to firm profitability.

Geographical scope of internationalization, however, addresses the ability to arbitrage operations across countries and leverage location-based advantages (Kogut, 1985). By supplying such advantages, geographical scope should improve performance.

If extent and geographical scope address different aspects of internationality and are not identical in their performance effects, the interaction of the two effects should affect performance independently of the individual effects.

For global firms, the economies of large scale plus the ability to leverage the concomitant market power across multiple boundaries and to seek less competitive markets for monopoly rents suggest a positive interactive effect. At the same time, a multidomestic strategy might imply that many markets simply dissect large amounts of

overall international activity into many small, independent, and nonreinforcing parts that destroy any potential scale economies. Empirically, Ramaswamy (1993) showed that international configuration or scope of operations, acts to moderate the scale effects of multinationality. The positive effect of configuration causes the effect of multinationality to change sign while retaining a low level of significance. He suggested that this may explain the instability of results in studies of multinationality.

In addition, a presence in multiple, diverse international markets can lead to advantages related to increases in market power and gains from the diversification of revenues (Ramaswamy, 1992). These potential economic benefits from foreign sales and geographical scope suggest that their interaction should have a positive impact on firm profitability.

Hypothesis 6: Performance should vary positively with the interaction of foreign sales level and level of international scope.

Empirical study

Sample

Data were gathered through a questionnaire that was randomly mailed to 1800 SMEs from seven mature industries in Spain (food processing, shoe manufacturing, tiles and ceramics, machine-tool producers, furniture, textiles and road transportation). The questionnaire was reviewed by two professors (distinct from the authors) specialized in internationalization and strategic management for construct validity. The revised version of the questionnaire was pre-tested, through personal interviews, with five CEOs from SMEs operating in mature industries. The final questionnaire, a letter by the

researchers explaining the purpose of the research and a letter by local authorities encouraging participation were sent to the CEO of each company¹ during the year 2003.

Overall, we obtained primary data from 301 SMEs from seven industries (furniture; textiles; tiles and ceramics; road transportation; food processing; machine-tool producers; and shoe manufacturing). Six questionnaires were ineligible because the research instrument was inadequately completed. Thus, we obtained a total of 295 valid questionnaires. The response rate (16.39 %) is comparable with that of other studies that have used a similar research design in Spain (Entrialgo, 2002; Suárez-Ortega and Alamo-Vera, 2005; Casillas and Acedo, 2005). Furthermore, this response rate is acceptable in view of the fact that surveys of top management generally tend to have relatively low response rates (Caligiuri et al., 2004; Sambharya, 1996; among others).

For the purposes of the paper, we selected a sample composed only by SMEs that acknowledged a regular international activity. Finally, 181 firms were used in the analyses. These firms are from traditional industries, which are mostly mature and fragmented in nature. Hence, the effect of industrial sector on internationalization has been somewhat controlled for by selecting companies operating in markets with low growth rates.

Measurement of variables

Dependent variable.

¹ We obtained firms' addresses and names of CEOs from the SABI-INFORMA database (Bureau Van Dijk and D&B Informa), the most important source of business and financial information in Spain. CEOs were assured that their company would not be identified by name at any time, and that the results would be presented only in an aggregate and anonymous form. In return for their participation, we promised to send the respondents a copy of the results of the study, which were mailed during 2004.

We measured performance as a three-year average ROA (2003-2005 period). Averaging served to smooth any potential fluctuations associated with a single year's performance. We obtained performance data from the SABI-INFORMA database.

Independent variables.

We defined the **scope** of internationalization as the number of countries in which the SME operates during the year 2003 (Sapienza et al., 2005).

Moderating variables.

In the survey, CEOs were first provided with a definition of a TMT (“a group of senior managers that generally makes decisions that are important to the firm’s future”) and were then asked to identify and provide demographic information about those who had been members of their TMTs over the past two years. **Educational level** was defined as the percentage of managers with university level of education (Wiersema and Bantel, 1992; Datta et al., 2003). We used the percentage of managers with previous experience in other firms, sectors and/or markets to measure the level of **experience** of the managerial team (Finkelstein and Hambrick, 1990). The **involvement of family members on TMT** was measured as the percentage of managers pertaining to the owner-family (Chrisman et al., 2005; Ensley and Pearson, 2005). We measured the **extent of internationalization** as the ratio of foreign sales over total sales (Riahi-Belkaoui, 1996).

Finally, a twelve-item scale measured the **Strategic Orientation** construct. This scale was adapted from existing instruments proposed by Covin and Slevin (1989), Venkatraman (1989), and Morgan and Strong (2003). We asked respondents to characterize their firm’s SO in terms of these twelve items, and we used the average

rating as the firms' SO score. To assess construct validity, we ran a factor analysis. In exploratory factor analysis, the factor loadings for the items included in the SO scale indicated the existence of four dimensions (aggressiveness, analysis, innovation and risk-taking). Two items showing factor loadings lower than 0.60 were dropped from the scale (see Table 1, items V7 and V12). Next, we subjected the remaining set of items to Confirmatory Factor Analysis (CFA) using EQS software to assess construct validity and the overall model fit for four-factor solution. Figure 1 shows a diagram of the final scale, and Tables 1 and 2 list the items included in each dimension and the fit indices for SO scale.

[Figure 1 goes about here]

[Table 1 goes about here]

[Table 2 goes about here]

We assessed the reliability of the scale by analyzing Cronbach's alpha. The alpha level for the strategic orientation scale was 0.720, which is an acceptable level according to Nunally and Bernstein's (1994) recommendations (levels above 0.70). The scale also presents convergent and discriminant validity. To assess the dimensionality and convergent validity of the scale, we observed the results of the CFA. All factorial loadings had acceptable magnitudes (higher than 0.6) and were highly significant, as their t-values were higher than 3.291 ($p < 0.001$). Moreover, the value of the Bentler Bonett Normed Fit Index (BBNFI) for our scale was 0.932, exceeding the recommended value of 0.9 and indicating strong convergent validity (Bentler and Bonett, 1980). To assess discriminant validity, we performed a correlation analysis among the dimensions of SO (aggressiveness; analysis; innovation; and risk taking). The four dimensions (factors F2 to F5 in fig. 1) exhibited correlations below 0.90. Thus, latent variables explain different concepts and our scale exhibits discriminant validity.

After assessing the reliability and validity of the scale, we determined the firms' SO to be the mean of scores from the ten items finally included on it. Although the correlations between the four dimensions of the SO scale were below 0.50, indicating that they may vary independently, we did not expect any significant differences between the four dimensions and the level of internationalization. Therefore, we used an aggregate measure of the SO of the firm, following Kreiser et al.'s (2002) recommendations when no differences are expected.

Control variables.

Company size and **age** have also been found to affect organizational processes and performance (Covin and Covin, 1990; Wiklund, 1999; Kumar et al., 2001; Johnsen and McMahon, 2005; Covin et al., 2006; Poon et al., 2006). Therefore, these variables were also included as controls. Respondents were asked how many individuals were working in the company at the time of the survey, to control for the effect that company size could have on the international scope-performance relationship. Small firms often lack financial resources for investing in assets and resources needed to overcome barriers such as the liability of foreignness.

Finally, respondents were asked for the year their company was founded, to control for company age. Older firms owe a higher portion of performance to their competence in established tasks, whereas younger firms' performance is more dependent on recognizing new business opportunities. Therefore, internationalization has a greater potential to affect firm performance for younger firms.

Results and Discussion

Before running the main statistical analysis, the correlation matrix of independent and moderating variables was examined. We centered the measures for each value by subtracting the mean value for each. This procedure reduces the correlation between an interaction and its composite terms, without altering substantive interpretations of the coefficients (Aiken and West, 1991). **Table 3** shows the correlation matrix and some descriptive statistics.

[Insert Table 3 about here]

Hierarchical regression analysis was used to introduce the variables into the model. In all equations, the control variables were entered before the other independent variables to partial out their effects from the relationships of primary interest. The hypotheses were tested using the moderated regression analysis technique recommended by Arnold (1982). To determine whether the variables have distinct or overlapping moderating effects, these effects were tested in separate models for each hypothesis. The analysis was conducted using the SPSS 15.0 software, and the results are shown in **Table 4**.

[Insert Table 4 about here]

Model 1 is the base model containing only the control variables. Consistent with the results of Wiklund and Shepherd (2005), Johnsen and McMahon (2005), and Poon et al. (2006), company size was found to have a positive effect on performance. However, company age does not significantly predict performance levels.

Model 2 contains results pertaining to the main effect of internationalization scope on performance. Hypothesis 1 predicted an inverted U-shaped curve for the

relationship between the number of countries and firm profitability. The number of countries term is positively signed and its squared term is negatively signed. Overall, the results suggest that firm profitability improves with initial international activity but declines with a greater extent of internationalization, providing support for the hypothesized inverted U curve relationship between the level of internationalization and SME profitability. This result is consistent in all the models with the moderating effects (models 3-7).

To study the moderating effects on the level of internationalization-performance relationship, models 3 to 7 focus on the interaction terms. To guard against spurious significance of the interaction result, we checked whether the overall change in fit of models 3 to 7 was significant, compared to model 1, the baseline model, after the inclusion of the interaction term. As can be seen from the model indices, the improvement in models fit (change in chi-square) was significant at $p < 0.01$ in all models, indicating that the interaction term significantly improved model fit.

Model 3 tests Hypothesis 2 which predicted a positive moderating impact of SO on the relationship between international scope and performance. As expected, the interaction term is significant and signed as predicted, indicating that proactive behaviors exerted a positive influence on the firm profitability impact of internationalization degree. Decisions with regard to international expansion imply a high level of complexity and uncertainty as the firms enter into markets different from the more familiar domestic market. Firms with proactive strategic orientations are willing to make risky decisions and are expected to exhibit higher levels of risk tolerance in ambiguous situations such as those involved in internationalization (Sapienza et al., 2005; Knight, 2001). Moreover, such orientation may be especially important for firms operating in low munificent or competitive environments (Covin

and Slevin, 1991; Miller, 1983; Wiklund, 1999; Zahra, 1991). A firm with a proactive orientation will respond to environmental conditions through searching for new businesses or markets, and trying to shape the nature and direction of competition to its own advantage. However, low munificent industries also require continuous searching to identify problems and opportunities, conducting extensive analyses, using formal planning processes and adopting a longer-term vision to understand and deal with threats (Goll and Rasheed, 1997 and 2005; Morgan and Strong, 2003). Consequently, in mature industries, entrepreneurial but also analytical attitudes should be adopted by firms in order to face environmental challenges. These actions would help firms to acquire sustained rather than temporary high performance levels (Zahra and Covin, 1995).

Model 4 contains results regarding the moderating influence of TMT's level of education on the relationship between internationalization and performance. We found a non-significant relationship and thus we cannot confirm hypothesis 3. We expected that executives with higher levels of education would have greater cognitive abilities to manage complex situations and would enhance the positive effect of internationalization on profitability. However, the level of education may be not sufficient to explain such relationship. The variety of specific academic disciplines as well as the combination of different functional backgrounds of managers could play a significant moderating role in explaining internationalization degree-performance relationship and, thus, they should be investigated in future studies. Indeed, previous studies have found that diversity in cognitive perspectives facilitates creativity, innovativeness and analysis and result in better strategic decisions and results (Wiersema and Bantel, 1992).

Model 5 tests the interaction between TMT's previous experience and internationalization. The interaction term was positively signed, thus providing

empirical support to Hypothesis 4. SMEs with more experienced TMTs may find easier to achieve manage the complexity associated with high level of internationalization as the knowledge acquired in other firms or markets reduces uncertainty about the external environment (Lu, 2002). Experienced top executives are capable to make the best use of the opportunities available in foreign countries and to formulate and implement effective strategies, enhancing the gains from geographical diversification.

In Model 6, the interaction between involvement of owner-family members in the TMT and internationalization is negatively signed, indicating that high number of family members in TMT had a negative influence on the relationship between level of internationalization and firm profitability. Thus, hypothesis 5 is supported. Family firms usually have a stable organizational culture that favors independence and is characterized by strong routines and personal values, inhibiting their ability to face changes and new business opportunities, and thus reducing their capacity for growth in foreign markets (Carney, 2005; Wiklund et al., 2003). In contrast, firms less controlled by family members are more likely to explore new arenas and improve profitability by procuring better quality and cheaper raw material in other markets and learning global best practices and competitors' strategies (Zahra et al., 2004).

Finally, Hypothesis 6 predicted a positive impact of foreign sales volume on the country scope-performance relationship. Results in model 7 do not allow us to support this relationship as the interaction term is non-significant. As SMEs increase their internationalization degree (extent and scope), the gains are likely to increase but at the same time, extensive international activities entail high level of governance costs and greater managerial information demands (Jones and Hill, 1988). Therefore, SMEs may not be able to make full use of the benefits that come with a high level of internationalization because of their limited resource endowments.

Conclusion

In this paper we try to explore the relationship between SMEs' performance and internationalization. This relationship has been widely analyzed in the literature with regard to large firms, but in a lesser extent with reference to SMEs. There is a widespread consensus that the effects of foreign expansion on the profitability of SMEs have not been studied sufficiently (Coviello and McAuley, 1999; Covin and Slevin, 1991).

SMEs cannot be considered smaller clones of larger enterprises because their strategic management and their internationalization policies differ substantially from those of the large firms (Wyer and Smallbone, 1999; Majocchi and Zucchella, 2003). Moreover, SMEs usually have more limited resources, capabilities and market power than large firms to cope with the risks and complexities of foreign expansion (Morgan and Katsikeas, 1997). Therefore, the results of the research concerning large firms cannot be automatically applied to smaller companies. Our results highlight the importance of managerial characteristics and SMEs' strategic orientations that might moderate the internationalization-performance relationship.

Our research has argued for and found an inverted U-Shaped relationship between the SMEs' international scope and performance as other previous studies have observed (Daniels and Bracker, 1989; Geringer et al., 1989; Gomes and Ramaswamy, 1999; Hitt et al., 1997). This result indicates that firms initially experience the positive returns to internationalization, albeit the initial challenges due to the liability of foreignness; the continued positive benefits induce managers to continue expanding internationally. Eventually the positive benefits can reach an optimal point; negative performance results from increased international diversification because of the

increased organizational costs related to managing a high degree of international diversification, beyond the optimal point (Roth, 1992).

The inverted U-shape calls attention to the existence of a threshold of internationalization. It is widely recognized the benefits of performing activities in many countries (market power, learning, etc.), but there are significant costs associated to the international expansion that must be considered. International diversification is complex and difficult to manage, and escalating geographic dispersion can enormously enhance transaction costs and managerial information-processing demands. As a result of the transaction costs and processing demands, the costs of international diversification will sometimes exceed the benefits of the diversification, suggesting an inverted U-shaped form between internationalization and performance relationship.

We also find evidence that this relationship is highly context-dependent. Although this perception has been subject to growing research interest in recent years, it has not yet been investigated adequately enough to fully understand the extent to which interacting variables shape the internationalization-performance relationship (Bausch and Krist, 2007). Our results indicate that the ability to manage complexity associated with operating in a higher number of countries is a key issue to contribute to the positive effect of internationalization on the firms' performance. SMEs' performance benefits more from international diversification when the managerial teams show a higher proactive behavior, hold previous experience in other firms or markets, and are less controlled by owner-family members. These characteristics provide SMEs with better skills and capacity to cope with increasing complexity of foreign markets. However, benefits of geographical diversification seem to be overlapped by costs associated with a high proportion of sales abroad, resulting in a non-significant interaction.

This research makes several important contributions. First, it supports the importance of considering the findings from an upper-echelons perspective on international business research. Studies from an upper-echelons perspective have analyzed how TMT characteristics influence the strategic choices made by companies and ultimately have an impact on performance. However, very little is understood about how the composition of TMT influences the effectiveness of strategies. Therefore, our paper tries to provide a more complete understanding of the role of top managers as moderators of the internationalization-performance relationship.

Second, the lack of a professionalized view in the strategic formulation in SMEs may have a bearing on the lack of adaptation to the environment, and consequently, it may account for the worst financial results of SMEs in relation to larger firms. Nonetheless, this situation does not take place in every SME. Our results evidence that SMEs operating in mature industries, whose managers promote a more proactive strategic orientation in their international expansion, outperform companies showing more defensive behaviours. SMEs have to innovate to remain competitive in such environments, but they must also use the appropriate management systems for problem solving and devote greater analytical endeavours to deal with increasing competition.

And, finally, many prior studies rely on secondary data to analyse the influence of internationalization profile and performance. This study provides evidence about this topic by asking managers about demographic data of the team and processes developed to analyze and integrate new information, to coordinate decisions, to examine the evolution of environmental factors and to assess new projects.

Furthermore, this paper has important implications for managers. Our findings indicate that internationalized SMEs whose managers promote a proactive strategic orientation and benefit from the cognitive diversity offered by executives with distinct

prior experiences in other firms or markets outperform better than SMEs not oriented to these types of behaviours. The involvement of family-owner members in managerial roles can limit the benefits of international expansion. Accordingly, these findings could lead to more informed corporate policies regarding executive staffing, development, and TMT composition.

Despite these contributions, this paper has some limitations that provide further research opportunities. First, although we used a lagged variable for the SMEs' performance measure, the cross-sectional nature of the data prevents us from making definitive causal statements, and therefore the use of longitudinal data in future research is desirable. For example, a reinforcing spiral effect probably occurs over time.

We emphasized the idea that a SME's specific characteristics, such as TMT level of education and experience, are important for managing complex information and may help firms to obtain better results and become more internationalized. However, other characteristics such as TMT size, age, the level of tenure heterogeneity, etc. may have a significant influence on the relationship between firm's internationalization and profitability. Therefore, future research would benefit from addressing this issue.

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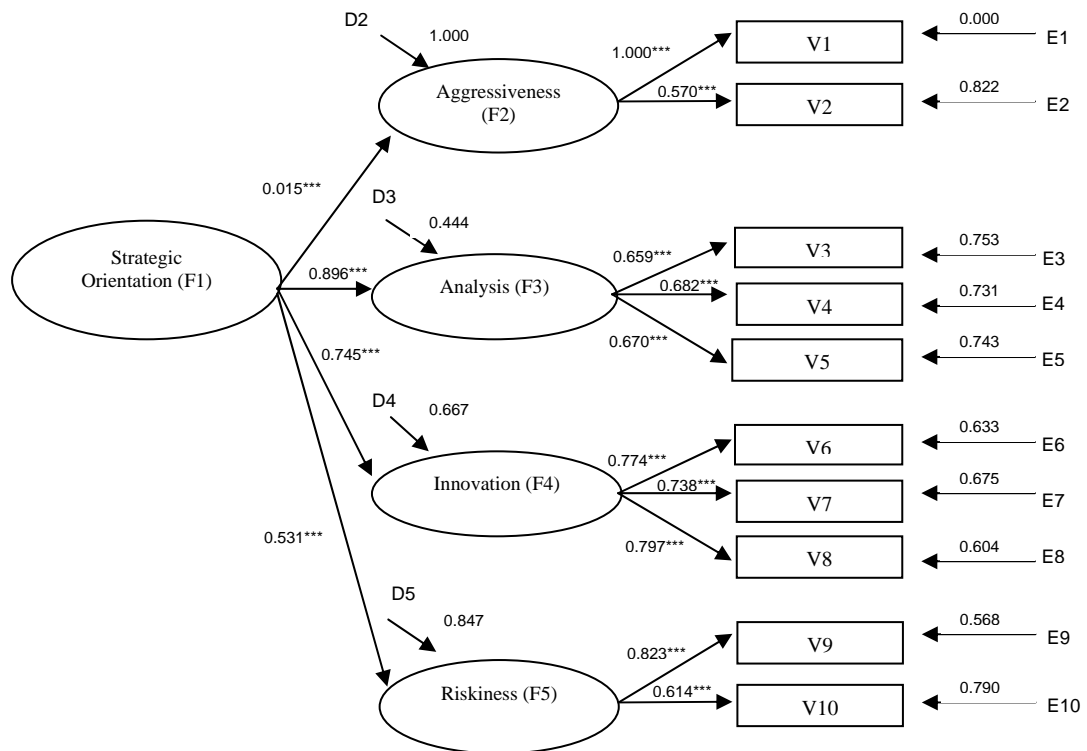
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Figure 1: Strategic Orientation Scale (Confirmatory Factor Analysis)



* $t > 1.96$; $p < 0.05$; ** $t > 2.576$; $p < 0.01$; *** $t > 3.291$; $p < 0.001$

Table 1: Strategic Orientation Scale's measurement

DIMENSION	Managers' perceptions about... (1: Strongly disagree; 2: Disagree; 3: Indifferent; 4: Agree; 5: Strongly agree)
Aggressiveness	<ul style="list-style-type: none"> - Sacrificing profitability to gain market share (V1) - Cutting prices to increase market share (V2)
Analysis	<ul style="list-style-type: none"> - Establish deliberated plans to cope with environment opportunities and threats (V3) - Emphasize effective information seeking and key information identification for decision-making (V4) - Follow formal procedures to coordinate decisions in different areas (V5)
Futurity	<ul style="list-style-type: none"> - Emphasize innovation to anticipate future market needs (V6) (<i>associated with the innovation dimension after EFA</i>) - Conduct prospective studies to examine the evolution of key environmental factors (V7) (<i>removed after EFA</i>)
Innovation	<ul style="list-style-type: none"> - Constantly seeking new products and markets (V8) - Usually the first ones to introduce new brands or products in the markets (V9)
Risk-taking	<ul style="list-style-type: none"> - Sometimes, decisions in the company have produced important changes in the way we operate as an organization (V10) - The company tends to develop less risky investment projects than competitors, although income expectations are lower (V11) (reverse-coded) - Assessment of new projects is based on intuition instead of analysis (V12) (<i>removed after EFA</i>) (reverse-coded)

Table 2: Goodness of fit (Strategic Orientation Scale)

Indices	Level of an acceptable fit	Level of our scale
BENTLER-BONET NOMERD FIT INDEX	Close to 0.9	0.932
BENTLER-BONET NONNORMED FIT INDEX	Close to 0.9	0.952
COMPARATIVE FIT INDEX	Close to 1	0.967
LISREL GFI FIT INDEX	Close to 0.9	0.960
LISREL AGFI FIT INDEX	Close to 0.9	0.929
STANDARDIZED RMR	Lower than 0.08	0.041

Table 3: Descriptive statistics and correlation matrix

Variable	Mean	S.D.	1	2	3	4	5	6	7	8	9
1. ROA (average 2003-2005)	2,93	5,81	1								
2. Scope of internationalisation	15	21.917	0.447**	1							
3. Extent of internationalisation (%)	38,29	27,43	0.040	0.389**	1						
4. Strategic orientation	3.4	0.574	0.225*	0.315**	-0.006	1					
5. Familiar nature of TMT (%)	66.57	42.4212	-0.355**	-0.380**	-0.134	-0.241**	1				
6. TMT's level of education (%)	43.53	35.8471	0.153	0.291**	0.029	0.208**	-0.309**	1			
7. TMT's experience (%)	20.96	31.0945	0.011	0.106	0.084	0.398**	-0.252**	0.169*	1		
8. Company age	47.20	199.68	-0.032	0.005	0.204**	-0.148	0.084	-0.075	-0.017	1	
9. Company size	76.19	157.126	0.514**	0.572**	0.195**	0.274**	-0.441**	0.260**	0.020	-0.019	1

* $p < 0.05$; ** $p < 0.01$

Table 4: Moderator influences on relationship between country scope and performance.

Variable	Model 1	Model 2 Hypothesis 1	Model 3 Hypothesis 2	Model 4 Hypothesis 3	Model 5 Hypothesis 4	Model 6 Hypothesis 5	Model 7 Hypothesis 6
Step 1: control							
Age_firm	-0.011	-0.030	-0.042	-0.031	-0.021	-0.051	0.003
Size_firm	0.507***	0.423***	0.284**	0.369***	0.355***	0.187	0.397***
Step 2: Independent							
Int scope (number countries)		0.644***	0.359**	0.672***	0.367**	0.629***	0.715***
Int scope squared (number countries squared)		-0.516***	-0.331**	-0.654***	-0.393***	-0.573***	-0.528***
Step 3: Moderator							
Strategic Orientation			-0.107				
Level of Education				0.007			
Experience					0.024		
Familiar nature						-0.090	
Foreign sales							-0.118
Step 4: Interaction Terms							
S. Orientation x Country scope			0.451***				
Level of Education x Country scope				0.189			
Experience x Country scope					0.308**		
Familiar nature x Country scope						-0.317*	
Foreign sales x Country scope							0.010
Model R ²	0.258	0.479	0.568	0.491	0.513	0.520	0.489
Adjusted R ²	0.241	0.455	0.534	0.454	0.478	0.476	0.454
Change in R ²	0.258	0.109	0.097	0.011	0.032	0.026	0.000
Model F	15.636***	20.238***	16.864***	13.331***	14.560***	11.745***	13.734***

Dependent variable: Performance (ROA 2003-2005)

*p < 0.1

**p < 0.05

***p < 0.01