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The internationalization of Australian innovative small-to-medium enterprises utilizing wholly foreign-owned entities in China

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Abstract

The purpose of the paper is to investigate how innovative, small-to-medium enterprises (SMEs) internationalize through utilizing wholly foreign-owned entities (WFOEs), as there is a little research explaining this. This paper presents the findings from in-depth case studies with 14 SMEs that internationalized to China as WFOEs. The SMEs internationalized as WFOEs in order to tap into opportunities and develop presence. WFOEs were developed either proactively or reactively, which provided a catalyst for internationalization. SMEs mostly used radical, game-changing product innovations. However, findings from the case studies revealed that the Chinese market did not always accept western innovations, and adaptations had to be made. A new conceptual model with a range of theoretical propositions for future researchers is developed, based on the findings.

KEYWORDS

emerging economies, innovation, international entrepreneurship, SMEs, wholly foreign owned entity (WFOE)

1 | INTRODUCTION

Doing business in emerging markets presents many challenges and opportunities, and foreign firms can fail due to a multitude of reasons in this environment (Carr & Harris, 2021; Das, 2015; He, Boateng, & Ring, 2019). Small-to-medium enterprises (SMEs)—the focus of this study—maybe at greater risk of failure due to limitations in their financial, technical, and managerial resources (Brouthers, Nakos, Hadjimarcou, & Brouthers, 2009; Lu & Beamish, 2001). Such constraints differentiate them from larger firms in terms of their approaches to innovation, operational scale, and decision-making characteristics, which influence how they internationalize (Dato-on, Banerjee, & Roy, 2018; O’Cass & Weerawardena, 2009). This has led to scholars offering new ways to theorize the internationalization of

SMEs (Andersén & Samuelsson, 2016; Hilmersson, Johanson, Lundberg, & Papaioannou, 2021; Paul, Parthasarathy, & Gupta, 2017); this paper contributes to this research literature by developing a conceptual model of how SMEs address opportunities and utilize their knowledge and innovation capabilities to internationalize into China as wholly foreign owned enterprises (WFOEs), which are defined as 100% foreign-owned limited liability companies with one or more foreign investors (Ku, 2013).

As is commonly known, China is expected to continue to grow to become the largest economy by 2030, offering international businesses many opportunities (Paul, 2016). In turn, there has been a significant increase in the number of foreign businesses entering China through different entry modes (Bing-sheng, 2004; Chang, Chung, & Moon, 2013). Research has demonstrated the critical role that international knowledge

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and innovation play in the successful internationalization of SMEs (Deligianni, Voudouris, & Lioukas, 2015). Although scholars have examined the phenomenon of firm internationalization from developed countries to emerging economies (Ramamurti, 2004), the majority of studies on innovation and SME internationalization, owing to their size-related constraints, focus on low-resource commitment entry modes such as exporting (Knight & Cavusgil, 2004; O'Cass & Weerawardena, 2009; Sui & Baum, 2014; Wakelin, 1998). However, some scholars have shown that smaller firms do choose higher commitment entry modes such as WFOEs (Aspelund et al., 2007), which can enhance their host market knowledge, facilitate long-term opportunities, and develop greater competitive advantages (Ripolles et al., 2018; Zahra, Ireland, & Hitt, 2000). Therefore, notwithstanding their resource limitations, the question of 'how' SMEs successfully internationalize through WFOEs is an important topic to explore in emerging markets.

Most studies have focused on high-tech SMEs and have thus overlooked the differences they share with low-tech counterparts when expanding into emerging markets. Contrasts in findings in the literature suggest that these firms are likely to differ in terms of their key resources, innovation activities, and how they internationalize (Crick & Spence, 2005; Spence & Crick, 2006; Taylor & Jack, 2013). Indeed, recent research has called for comparative studies that incorporate both types of firms, especially in the context of emerging markets where there are institutional voids (Sui, Yu, & Baum, 2012). In light of this, our study incorporates both low- and high-tech SMEs as we seek to address the following questions: *How do Australian SMEs identify and capture opportunities in their internationalization to China utilizing WFOEs? How do firm-specific capabilities such as innovation and knowledge enable the SMEs to leverage opportunities for firms in their internationalization?*

We address these questions through a multi-case study analysis of the experiences of 14 SMEs who had internationalized from Australia to China utilizing WFOEs, and contribute to the literature by offering a new conceptual model on SME internationalization. In the process, we address the critical issues SMEs face around what capabilities they need, innovation strategies they should use, and processes they should follow to succeed in foreign markets under higher commitment entry modes (Welch, Benito, & Petersen, 2007). By contextualizing our study in China, we also address calls to improve our understanding of context-specific issues when creating opportunities in international markets (Mainela, Puhakka, & Servais, 2014). In addition, this study answers calls for research examining issues around innovation in the Chinese context (Chatterjee & Sahasranamam, 2018; Heredia, Yang, Flores, Rubiños, & Heredia, 2020) and the use of international dynamic marketing capabilities (Xu, Guo, Zhang, & Dang, 2018).

2 | LITERATURE REVIEW

2.1 | Entrepreneurship and international opportunities

The entrepreneur's drive is identified as a key stimulant for the internationalization of SMEs (Oviatt & McDougall, 2005). This is grounded

in the views of traditional entrepreneurship theory (Covin & Slevin, 1989; Miller, 1983), where "proactiveness (actively entering new product/market spaces and seeking market leadership positions)" is a core element of a firm's entrepreneurial orientation (Anderson, Kreiser, Kuratko, Hornsby, & Eshima, 2015, p. 1581). Indeed, smaller-sized business strategies are often driven by the entrepreneur or management team, and their enthusiasm for internationalization generally leads to a higher degree of internationalization (Brouthers, Nakos, & Dimitratos, 2015).

In addition to proactiveness, the presence of an opportunity is another essential element for international entrepreneurship (Hilmerston et al., 2021; Oviatt & McDougall, 2005). Short et al. (2010, p. 40) assert that "without an opportunity, there is no entrepreneurship. A potential entrepreneur can be immensely creative and hardworking, but without an opportunity to target these characteristics, entrepreneurial activities cannot take place." This argument resonates with the international business literature, where internationalization has been defined as "the recognition and exploitation of entrepreneurial opportunities that lead to new international market entry" (Chandra, Styles, & Wilkinson, 2009, p. 31).

Although the literature is settled on the importance role opportunity has in the internationalization process (Johanson & Vahlne, 2009), it remains unclear when and how international opportunities are captured by SMEs through the proactiveness of the entrepreneur (Crick & Jones, 2000; Knight & Cavusgil, 2004), and when are they through serendipitous encounters (Chandra et al., 2009). In a study on high-tech SMEs, Crick and Jones (2000) found that a firm's managerial team's orientation to international markets was a vital driver behind internationalization. A comparative study among high-tech and low-tech SMEs found that the high-tech firms were more likely to internationalize (through exporting and licensing) proactively—reflected in their strategic thinking and planning, niche offerings, internationalization from inception, active searching, and the commitment of management to internationalization (Bell, Crick, & Young, 2004).

Proactiveness has also been evident in low-technology SMEs. Taylor and Jack (2013) found that the entrepreneurial drive of managers from Australian low-technology industries was a key driver for their internationalization to develop in psychically proximate markets (for example, culturally similar countries including the US, New Zealand, & the United Kingdom). Their motive for internationalization was also due to a limited domestic market and a need to capitalize on their product innovation before being imitated by competitors (Taylor & Jack, 2013), which is common in international new ventures (Knight & Liesch, 2016). In our study, we focus on a psychically distant host country where we explore how entrepreneurs capture business opportunities from a fast growing and evolving emerging economy; China.

The role of serendipity or chance is identified as another important factor in how international opportunities are identified and exploited (Chandra et al., 2009). Spence and Crick (2006) found that serendipitous events were a critical determinant of key decisions related to internationalization among UK and Canadian entrepreneurs, and Meyer and Skak (2002) found that firms in Eastern Europe identified foreign business opportunities by chance through contacts established at trade fairs. However, the

degree to which a serendipitous encounter is actually preceded by proactive search is often unclear. For example, Ellis (2011) found that although most opportunities are discovered, they are intentionally sought instead of encountered serendipitously. This resonates with Muzychenko and Liesch (2015), who found that the identification of international opportunities is determined by the manager's desire to build a world-class enterprise. In light of this, we pose the first research question (RQ1):

RQ1: How do Australian SMEs identify and capture opportunities in their internationalization to China utilizing WFOEs?

2.2 | Innovation as a dynamic capability

A firm's capabilities play an important role in the identification and exploitation of opportunities in international markets. Innovation is one capability that is central to the entrepreneurship literature, as it determines the originality and competitive relevance of the product and/or service portfolio that is introduced into overseas markets (Anderson et al., 2015; Miller, 1983). Innovation takes many forms, evident in their products, processes, services, marketing activities, and business models (Najmaei, 2014), and acts as a stimulant for growth, profitability, and organizational success by adapting to customers in foreign markets or by contributing to cost advantages (Kumar, 2014).

Although there is a reasonable body of literature that predominantly looks at SMEs' exporting and innovation (see Love & Roper, 2015), there is a lack of research exploring the role of innovation in the establishment of higher commitment entry modes, such as WFOEs in emerging markets. One explanation for this skewness toward exports is related to the resource constraints faced by SMEs (Lu & Beamish, 2001), who favor exports for their flexibility and cost-effectiveness (Knight & Cavusgil, 2004). Notwithstanding this view, previous research has also shown that SMEs utilize a range of entry modes extending beyond exporting (see Melén & Nordman, 2009). Hence, WFOEs is a relevant entry mode to explore.

We address this gap by examining the role of organizational innovation (product, process, marketing, and business model innovation) in the internationalization of SMEs through WFOEs in China (Ku, 2013; O'Cass & Weerawardena, 2009). Exploring this context lends interesting new insights into how firms can overcome their resource constraints to establish a physical presence in institutionally distant markets, which may prove critical for enhancing and sustaining their competitive advantage (Ripolles et al., 2018; Zahra et al., 2000).

Research has demonstrated that innovation plays a significant role in the successful internationalization of SMEs (Bell et al., 2004; Crick & Jones, 2000; Suh & Kim, 2014; Taylor & Jack, 2013). For example, Crick and Jones (2000) found that product and process innovation influences the rapidity of internationalization through alliances and subsidiaries as forms of entry mode into developed markets. Bell et al. (2004) found that an important stimulus for UK firms to internationalize was either to gain access to R&D funding via alliances or capitalize on their product and process innovation through licensing with

foreign manufacturers, whereas establishing a WFOE in the form of a sales entity maybe cost prohibitive (Bell et al., 2004). Taylor and Jack (2013) found that low-technology SMEs internationalized by establishing WFOEs in other developed markets to capitalize on their product innovations and gain a first-mover advantage before they were imitated by host market competitors. However, three decades of research have yet to arrive at a consensus on how and when the costs of establishing higher commitment entry modes outweigh the costs and risks of forfeiting operational and IP control, which has been further complicated by the rise of emerging markets (Zhao, Ma, & Yang, 2017).

2.3 | Knowledge

An SME's knowledge base is important for developing innovative products that can help firms successfully internationalize into foreign markets (Deligianni et al., 2015). The knowledge-based view (KBV) (Grant, 1996) holds that knowledge is vital for a firm to achieve favourable strategic outcomes. Technological knowledge is defined as "knowledge associated with products, technologies and/or processes" (Burgers, Van Den Bosch, & Volberda, 2008, p. 56); it is important because it reflects the entrepreneur's ability to meet product demand through the development of new products (Clarysse, Wright, & Van de Velde, 2011). This enables the entrepreneur's responsiveness to competitors by increasing product/service functionality, in addition to reducing costs (Wiklund & Shepherd, 2003). Empirical research has shown that firms with superior technological knowledge are better able to adapt and grow in new markets (Autio, Sapienza, & Almeida, 2000), while outperforming foreign market competitors (Suh & Kim, 2014).

Our review of the literature suggests that research into the role of knowledge in the successful establishment of higher-commitment entry modes for SMEs in emerging markets is scant (Knight & Liesch, 2016); studies have focused on exploring the knowledge intensity of large MNEs in such contexts (Zhao et al., 2017). Some scholars such as Deligianni et al. (2015) have explored how the configuration of technological, market, and international knowledge enabled the internationalization of Greek SMEs through subsidiaries; however, they focus on the developed markets of Europe and the US. Suh and Kim (2014) found that technological capabilities, international marketing, and customer relationship management are important capabilities that influence the internationalization performance of the firm. Although their study incorporates high-commitment entry modes such as joint ventures and offices, there is no emphasis on WFOEs in emerging markets (Suh & Kim, 2014).

Spence and Crick (2006) found that the reputation of SMEs that possess technological advantages was important in attracting overseas customers. Although higher-commitment entry modes were less evident, findings suggest that offices/subsidiaries were established in foreign markets when a local presence was deemed necessary by the entrepreneurial team (Spence & Crick, 2006). This has also been evident in low-technology SMEs, where seeking proximity to foreign

customers was a key driver behind the allocation of resources in foreign markets in the form of subsidiaries or offices (Taylor & Jack, 2013).

Market knowledge is another form of knowledge that it is relevant for both high-tech and low-tech SMEs. Burgers et al. (2008, p. 56) define market knowledge as “knowledge associated with targeting customer set, entering markets, distributions channels, marketing approaches, and business models.” Scholars posit that market knowledge makes the exploration and leveraging of opportunities for entrepreneurs more efficient due to their sharper awareness of customer needs (Wiklund & Shepherd, 2003), and their insight into the effective methods that they can utilize (Burgers et al., 2008). International market knowledge also can help address the firm's exposure to the liability of foreignness (LOF) (Zaheer, 1995), where a familiarity with the foreign market's business and institutional environment mitigates the risks associated with internationalization (Eriksson, Johanson, Majkgard, & Sharma, 1997; Johanson & Vahlne, 2009). Sapienza, Autio, George, and Zahra (2006) suggest that a manager with previous international knowledge compensates for a lack of organizational knowledge by importing established routines from previous employment. This reduces the time and costs required for applying an internationalization strategy and improves the firm's precision in opportunity capture (Sapienza et al., 2006).

Empirical evidence has demonstrated the role international knowledge plays in the internationalization process. Acedo and Jones (2007) found that education level, languages spoken, and international experience fostered higher levels of proactivity and lower perceptions of risk in internationalization. Muzychenko and Liesch (2015) found that the entrepreneurs' accumulated experience allowed them to assess risk and make calculated decisions that underpinned their desire to seek market opportunities. Lindstrand, Melén, and Nordman (2011) found that managers or employees with international experience assisted SMEs in the bridging of different backgrounds/mindsets and created a shared view on how markets should be penetrated. In light of this discussion, we develop the second research question (RQ2):

RQ2: How do firm-specific capabilities such as innovation and knowledge enable the SMEs to leverage opportunities for firms in their internationalization?

3 | RESEARCH METHOD

Given that robust theorizing on SMEs operating as WFOEs in China is not well established, a qualitative case study approach was chosen to further our understanding of this context and phenomena (Kontinen & Ojala, 2011; Yin, 2014). Quantitative studies examining innovation and internationalization focus on observable variables (i.e., the “what”) and overlook some finer details, we seek to explore in relation to ‘how’ firms internationalize and “why” they choose specific strategies (Fan, Zhu, & Nyland, 2012; Flick, 2009). Therefore, based on

Yin (2014) case study methodology, this study aims to understand less observable firm behavior and use analytical generalization to consolidate findings on SMEs internationalizing into China via WFOEs, giving voice to the actors.

Fourteen innovative Australian SMEs were chosen using the following purposeful sampling frame: the firm was: 1) Australian; 2) an SME with 1–200 employees; 3) innovative in at least one form (product, process, positional, or paradigm); and 4) conducting international business in China in the form of a WFOE. The SMEs were identified through the Australia China Business Council (ACBC) and AustCham Shanghai, Guangzhou, and Hong Kong, based in China. CEOs, business owners, or top-level executives who were involved in their China business operations were believed to be the most knowledgeable people to gain an in-depth understanding of their experiences. Twelve interviews were conducted face-to-face, and two were conducted through Skype. Secondary sources of information, including websites, media articles, and other published materials, were also utilized to facilitate data triangulation (Miles & Huberman, 1994).

Table 1 summarizes the activities, industry, size (measured by number of employees), innovation type, and entry modes of the 14 firms investigated. We also specify pseudonyms for each company, for example, Recruitment Co, Accounting Co, and others. A multiple case study method across the industries was chosen to validate the findings' robustness and derive generalized theoretical propositions (Yin, 2014).

Semi-structured in-depth interviews formed the primary data collection method, with interviews being conducted with one key informant selected from each SME. In addition, a semi-structured interview schedule was created based on the literature review. This approach to data collection was designed to generate insight regarding how (Kontinen & Ojala, 2011; Yin, 2014) factors such as international entrepreneurship, innovation and knowledge capabilities influence internationalization. The second author conducted the interviews, and the following open-ended questions, among others, were asked: “How did your internationalization to China come about?”; “What does your business in China do?”; “What entry mode are you using at the moment?”; “How do you describe your firm as being innovative?”; “What role does this innovation play in China?”; “What forms of knowledge do you use in your internationalization?”; and a range of demographic questions.

To start the analysis, the first two authors engaged in open coding (Corbin & Strauss, 1990; Glaser & Strauss, 1967), where transcripts were read line by line, and themes and categories related to their approach to internationalization (*proactive vs reactive*), innovation (*product vs positional innovation*), and knowledge type (*technological, specialist or international knowledge*) were established. This reductionist approach was necessary in the focusing, abstracting, and transforming of our raw data (Miles & Huberman, 1994). Once these categories were established, the main concept under examination was identified, namely “internationalization of SMEs using WFOEs.” Selective coding was then conducted where the relationships between the identified themes

TABLE 1 Sample summary: The Internationalization and Innovation Activities of Australian SMEs

Case	Firm	What does the firm do?	Industry type	Size	Locations in China	Innovation type	Entry mode/ business structure
1	Recruitment Co	Australian recruitment company who recruits for the Chinese mining sector	Business services	100	Beijing/ Shanghai	Positional/ product	Hong Kong entity ops in China
2	Accounting Co	Small accounting firm providing accounting and virtual CFO services	Business services	40	Shanghai	Positional/ product	WFOE - foreign partnerships
3	Vehicle Co	Vehicle warranty company providing warranties for used cars in China	Business services	100	Shanghai	Product	WFOE
4	Office Co	Virtual and actual office spaces and services	Business services	10	Beijing/Shanghai	Product	WFOE
5	Box Co	Innovator and producer of metal boxes and products	Manufacturing	200	Suzhou	Product	Hong Kong entity operating in mainland China
6	Biotech Co 1	R&D of diagnostic medical tools and medical programs	Biotechnology	400 (200 in Aust)	Nanjing	Product	Hong Kong entity operating in mainland China
7	Biotech Co 2	Provider of drug discovery research services and drug discovery services	Biotechnology	72	Shanghai/ Suzhou	Product	WFOE
8	Biotech Co 3	Contract research services/drug discovery and vaccinations	Biotechnology	6	Shanghai	Product	WFOE with partnership
9	Medical Equip Co	Innovator of new medical devices	Biotechnology	60	Shanghai	Positional/ product	WFOE
10	Metal Frame Co	Innovator and producer of metal frames for commercial construction	Building and construction	50	Shanghai	Product	WFOE
11	Architect Co 1	The landscape architecture for commercial real estate	Building and construction	50	Shanghai/Shenzhen	Product	WFOE
12	Architect Co 2	Heritage parks/landscape design	Building and construction	70	Guangzhou	Product	WFOE
13	Meat Co	Supplier of high quality organic meat products	Agriculture	5	Hong Kong	Process	Hong Kong entity (exporting)
14	Milk Co	Innovator and producer of organic milk products	Agriculture	30	Beijing and Shanghai	Positional/ product	WFOE

and the main concept under examination were investigated (Glaser & Strauss, 1967). Memos were jotted down about how different concepts influenced internationalization as a WFOE by identifying positive expression such as *major advantage*, *critical*, *important*, *improve*, and *helpful*. The write-up of these memos forms the basis of our findings and analysis presented in the next section.

4 | FINDINGS AND ANALYSIS

In the present study, the central concept is the internationalization of SMEs utilizing WFOEs. Table 2 presents the main findings of the fourteen cases.

4.1 | How did it come about that foreign SMEs setup as WFOE: By accident or design?

The proactive seeking of opportunities was evident in ten of the study's cases (see Table 2). This was identified by themes such as the entrepreneur's *international outlook* and proactive strategic planning. In line with previous research (e.g., Ellis, 2011; Muzychenko & Liesch, 2015), this drove them to seek and recognize opportunities in the Chinese market that could be exploited by deploying staff and resources to develop further market opportunities. These findings were evident in both low- and high-tech SMEs. Low-tech firms that engaged in the proactive seeking of foreign market opportunities either occupied an under-served niche in the foreign market and/or

TABLE 2 – Reasons for setting up as a WFOE, Entrepreneurship, Innovation, and Knowledge for Australian SMEs Internationalising to China

Case	Firm	Reasons for setting up WFOE	Time in China	Reactive	Proactive	Product innovation	Positional innovation	Technological knowledge	Specialist knowledge	International knowledge
1	Recruitment Co	No one else was doing it, offering a niche, setting up a Hong Kong entity for payments, presence	14 years	X			X		X	
2	Accounting Co	To service inbound/outbound clients, Chinese background	5 years		X	X	X		X	X
3	Vehicle Co	No one else doing this, niche. Wanted to expand	5 years		X	X			X	
4	Office Co	Saw a large opportunity for start-up businesses they service. A service provider has to have a physical presence	18 years		X				X	
5	Box Co	Wanted to have a worldwide presence from China, save on the cost of production, compete on a global basis	10 years		X	X		X		
6	Biotech Co 1	Multiple activities building up presence, moving to next stages of internationalization	30 years		X	X		X		
7	Biotech Co 2	Getting resources/skills in China, research projects, supplying medical projects to customers, want to be part of the Chinese pharmaceutical market, Chinese background	7 years		X	X		X		X
8	Biotech Co 3	Markets Australian software in China (window company), access the Chinese market, also does invoicing in China, Chinese background, not a lot of this nanotech technology, pioneers	10 years		X	X		X		X
9	Medical Equip Co	Access to funding and investment capital	4 years		X	X		X		X
10	Metal Frame Co	Client invitation and repeat business were exporting to China, now moved to China, and exporting from China. Products were innovative, 30 million RMB to grow. Reinvest in China	33 years		X	X	X		X	
11	Architect Co 1	Chinese guy invited us to do a project here, and office needed to do other jobs, coordinates with Australia	19 years		X	X			X	
12	Architect Co 2	Started to get some Chinese clients, it was easier to service the Chinese clients by being here. Known for designing parks	17 years		X	X			X	

TABLE 2 (Continued)

Case	Firm	Reasons for setting up WFOE	Time in China	Reactive	Proactive	Product innovation	Positional innovation	Technological knowledge	Specialist knowledge	International knowledge
13	Meat Co	Presence/international outlook, learn mandarin and based in Beijing, launched Hong Kong so they could get into Asia and China	10 years		X				X	
14	Milk Co	Had multiple inquiries after melamine milk disaster, also wanted to reduce exposure on the Australian market, small domestic market, important to have a presence, need to manage it themselves, still have an agent	10 years	X		X			X	X
Total				5	10	10	4	5	9	5

had a manager or partner with international experience. Quotes from Meat Co (low-tech) and Medical Equip Co (high-tech) indicate how firms proactively sought opportunities:

Through our strategic planning process, we identified China as being a growth market. As a result, we decided to be located in the market, rather than doing it all from Australia, so we moved up to Hong Kong to be in action, giving us a more global outlook on the business. (Meat Co)

According to this case, a proactive choice was made to enter as a WFOE to give the firm a presence; it also gave them a global outlook to other international opportunities, so a higher commitment mode was needed. This example is indicative:

We are entrepreneurial in the sense that we are always looking at what we do ... and seeing how we can chase down business opportunities. For instance, you have got all the Western health issues, which will also happen in China – diabetes, aging population etc. So there are huge opportunities in the medical sphere where we can bring Australian technology over there. In addition, the total budget for commercialization in Australia is \$80 million: it is nothing compared to China, where it is worth \$2 billion annually. (Medical Equip Co)

The above statement suggests that proactiveness comes from firms seeking larger markets than Australia. In addition, Medical Equip Co's main reason for setting up a WFOE was to access the large funding in China for innovation and investment capital which was not available in Australia.

Reactiveness to foreign market opportunities was evident in four cases, with three cases being low-technology firms. These firms addressed an underserved niche in China, and opportunities were identified objectively but not entirely through serendipity. Managers either reacted to inquiries from potential clients in China (Milk Co and Metal Frame Co) or responded to clients who invited them to follow them into China due to their specialist expertise (Recruitment Co). Managers from these cases reflected a lack of international knowledge and vision prior to internationalization, which distinguished them from proactive low-technology SMEs, who had these assets. Evidence from these cases suggests that possessing a differentiated product that caters to an underserved niche in an emerging foreign market may lead to a firm recognizing and capitalizing on opportunities needed by clients or major partners. This supports arguments from results of previous studies (Chandra et al., 2009; Ellis, 2011), and extends their findings into the context of WFOEs in emerging markets. The following statement supports these views:

... the melamine issues emerged here, and so we ended up with many calls, much interest, and probably

through lack of facts more than anything, just gut instinct, we thought let's go, and that's how we ended up here We had emails, some weeks we had 100 inquiries a week, it was huge. (Milk Co)

Milk Co's internationalization was fuelled by strong demand from Chinese customers who perceived Australian milk products to be "clean" and "safe" compared to local producers. In the case of Recruitment Co, their international entrepreneurial venture was initiated by grabbing hold of an opportunity that was presented to them:

The influencing factor to do this was the fact I had a cornerstone client that made it compelling... I was entrepreneurial by taking an opportunity in that niche space and taking it....and no-one else had done that. (Recruitment Co)

Biotech Co 1 established operations in China through serendipity. A coincidental meeting between two scientists twenty-seven years earlier, who wanted to solve health problems, led the firm to engage and "collaborate with Chinese colleagues." The role of this serendipitous encounter in leading to a dedicated China presence should not be overstated, as it was based on short-term activities in China described by the respondent as "not truly seen as long term Biotech Co.1 initiatives." They found that short-term projects allowed for a level of familiarity in China. The possibility of stronger presence in China had only recently become apparent with the establishment of a WFOE. This indicates the time required for some firms to establish a physical presence (e.g., through a WFOE) in a market after an opportunity is identified:

... now we have an increasing emphasis on the biotech sector in China, all of these disparate activities are now being seen as part of a coherent whole, and so we have started to talk just in the last probably four or five years about the China program and we as of last year have entered into another phase of active expansion. (Biotech Co.1)

The findings suggest that although foreign market opportunities may be identified through serendipitous encounters, a level of relationship building, opportunity seeking, and time to establish legitimacy is required to build a long-term presence. This extends the findings of previous studies (Spence & Crick, 2006), which focus on exporting and do not explore how a serendipitous encounter may lead to a long-term presence in an emerging foreign market.

4.2 | How was innovation used in the internationalization of SMEs?

In terms of the role of innovation, it was found that product innovation was the most evident type of innovation used by SMEs (10 cases)

(Table 2). Previous research has demonstrated that a firm possessing a unique product will achieve successful internationalization (Knight & Cavusgil, 2004; Sui & Baum, 2014). Product innovation was evident in all of the high-tech SMEs and four low-tech SMEs, where both types of firms offered a new and differentiated product to the Chinese market. The following is an example:

We have a service we call the "Virtual Chief Finance Officer (VCFO)", which we introduced as a very new concept to the local accounting industry... It is very different because, in China, it's very rare that you find a finance position such as a CFO can be a part-time ... it is really an innovative concept to the Chinese market. (Accounting Co)

However, other findings suggest that swift deployment, adaptation, and marketing of the SME's innovations were significantly constrained by their limited resources, as further elaborated by Accounting Co:

We don't have the resources at the moment but to align with our Australian strategy... we are working slowly because we do not have a lot of labour resources here to do that and we don't have a fully time marketing senior to support us. (Accounting Co)

Moreover, although product/service innovation was found to be advantageous for SMEs, it was found that in some cases, the traditionalist nature of the Chinese marketplace may offer some resistance to radical and unfamiliar products/services. The following observation was made:

In China, you cannot really be innovative because they are not interested in innovation. They are only interested in fast construction and making money. Innovation is hard to get in China because they work on the theory that if I change how I build something, it will take longer to build and will cost more. (Architect Co 1)

Zahra and Bogner (2000, p. 145) suggest that in the case of competitive hostility, the introduction of radically new products will decline: "since radically new products usually represent a major departure from existing and known product attributes, the risks and high costs associated with their development might not be an acceptable risk." Hence, in some cases, firms may be better off competing as followers rather than pioneers of new products that the Chinese have not experienced before.

Positional/marketing innovation was evident in four cases (Recruitment Co, Accounting Co, Meat Co and Milk Co) and was vital for low-technology SMEs. Similar to Francis and Bessant (2005), these cases demonstrated a clear brand identity, addressed a niche in their market, and were supported by innovative marketing techniques which relied on "social media", "search engine optimization," "video

conferencing,” “market positioning,” “creative branding,” and “creative event management.” A quote from Milk Co further articulates the role positional innovation had on the firm's success in a foreign market:

... it is the fact that we have a clearly defined brand. We came here, and we knew what our brand meant, and so our communications to consumers as well as the business world here were easy, 100 percent Australian, 100 percent certified organic, that's it... So I think if you come here not having a clear brand message, you would just be lost because there is so much going on here... it is very difficult for a company of our size to compete in TV advertising. We just need to look at innovative ways of getting customer brand awareness. (Milk Co)

Indeed, positional innovation was found to provide firms with a competitive advantage and a clear message to the market and allowed them to overcome their liability of smallness (Aldrich & Auster, 1986) and foreignness (Zaheer, 1995). Recruitment Co further articulates the advantages they observed from focusing on a niche market like China and has developed a reputation in the market:

My advantage is clearly that I am in a niche. So I compete with the biggest... We have the same type of brands in headhunting, so there are four or five dominant players, and I compete with them, and I beat them most of the time when I go against them ...because I compete in a niche, and have branding/reputation in this market, so I get repeat clients. (Recruitment Co)

Positional/marketing innovation was not evident in any of the high-tech SMEs who participated in this study. One observed that e-marketing was inappropriate for their business as they relied on customization, personal contact, and business-to-business (B2B) dealings. On the other hand, the R&D intensive, non-manufacturing SMEs (Medical Equip Co, Biotech Co 1 and 2) referred to larger partners to manufacture their innovation breakthroughs and thus depended on their business contacts to market their innovations. Findings suggest that by outsourcing activities and focusing on innovative core competencies, high-tech firms can address challenges related to their resources constraints. On the other hand, low-technology SMEs may need to compensate for their lack of technological innovation by relying on positional innovation— occupying a niche in their market and utilizing innovative marketing techniques (Francis & Bessant, 2005), to achieve a competitive advantage in an emerging market such as China.

4.3 | Organizational knowledge sustaining the firm in an emerging market

To address research question 2, Table 2 identifies the knowledge-based resources that contributed to the internationalization of

SMEs to China. Technological knowledge was evident in all five high-tech firms (Medical Equip Co, Box Co, Biotech Co 1, 2, and 3) and was found to support the firm's product innovation. However, this technological knowledge can also be specialist knowledge for high-tech firms. Previous research indicates that technological knowledge gives firms a competitive advantage, which facilitates the successful internationalization of the firm (Autio et al., 2000; Deligianni et al., 2015; Oviatt & McDougall, 2005). The following is indicative:

So, it is commercializing research, raising capital, licensing technology, conducting the engineering, and developing the technology; we run clinical trials working with universities, so it is quite complex... The feedback we have got from people in China is that the Chinese are not particularly innovative with technology. So the advantage we have is that we can deliver novel, sophisticated technology to the market and have excellent technical capability to do that. (Medical Equip Co)

Technological knowledge was not evident in the eight cases that were low-tech SMEs. However, specialist knowledge was found to support the low-tech SMEs in developing capabilities to address a niche in the foreign market and compensate for their lack of technological knowledge. Findings suggest that all nine low-technology firms (Recruitment Co, Accounting Co, Milk Co, Metal Frame Co, Meat Co, Architecture Co 1 and 2, Vehicle Co and Office Co) relied on specialist knowledge to support operations in their respective markets. This allowed SMEs to identify the target market they wanted and focus their limited resources on a particular niche. This finding is in line with Zahra and George (2002, p. 193), who proposed that a firm's existing knowledge “influences the locus of search” of the firm. Responses from Metal Frame Co elaborate on this matter:

We try not to do bigger and better than everyone, but we are trying to do what we do better, so we picked some segments that we think we are good at... we have been brought in because they know we can do export, they know we can design and build the project for them. (Metal Frame Co)

When combined with technological or specialist knowledge, international knowledge was found to further contribute to the competitive advantage of the SMEs in China. This was evident in four cases (Biotech Co 2, Biotech Co 3, Architect Co, and Accounting Co), where the founder/manager was an Australian citizen with either business experience in Asia or a Chinese background:

... Local market knowledge is critical because I was born in China, so I think I know Chinese culture pretty well. However, I was educated in Australia, so I know the education system here and how research is done...

So, I have particular leverage in China that most people might not say. (Biotech Co 2)

... we have had business experience in Asia before, Hong Kong, in particular, we set up an office in Hong Kong. (Medical Equip Co)

In four cases (Biotech Co 1, Box Co, Metal Frame Co, and Milk Co), managers who lacked foreign market knowledge were found to hire managers and staff with local market knowledge to overcome their liability of foreignness (Zaheer, 1995). The representative of Metal Frame Co articulates this:

My advice dealing with “guanxi” would be; do not waste your time even trying to work it out or think about it, or plan around it. Just get a good Chinese manager and say, “Look, this is the target...” and let him run with it. (Metal Frame Co)

Our findings suggest that international knowledge embedded in the entrepreneur or their employees enables both high-tech and low-tech SMEs to overcome the liability of foreignness (Zaheer, 1995). This is in line with previous studies which found that international knowledge/experience provides firms with an advantage over competitors in navigating through a foreign market's institutional, cultural, and business environment (Eriksson et al., 1997; Musteen, Francis, &

Datta, 2010; Sapienza et al., 2006). It also aligns with studies which posit that the development of foreign market knowledge and experience is vital during the internationalization process (Johanson & Vahlne, 1977).

5 | CONCEPTUALIZATION AND DISCUSSION

Figure 1 summarizes our findings by presenting a conceptual model of the factors that influence the internationalization for SMEs, and proposes ways in which entrepreneurs can internationalize into China by establishing WFOEs.

In this model, internationalization as a WFOE can occur through two different paths: proactive or reactive. While both paths resulted in internationalization, we argue that firms will be categorized in different ways. If a firm is proactive, it will have an international outlook and establish an international presence to actively identify and pursue further foreign opportunities. Whereas, for reactive SMEs, serendipity will play a role; the ability to capture opportunities, referred to by (Crick & Spence, 2005) as the objective discovery of opportunity, will be important. That is, for a firm to capture foreign market opportunities, its capabilities must be aligned to the opportunities regardless of whether they are identified through proactive or reactive encounters. Other studies have focused on examining the role of innovation in the internationalization of SMEs in the form of exporting (Higon &

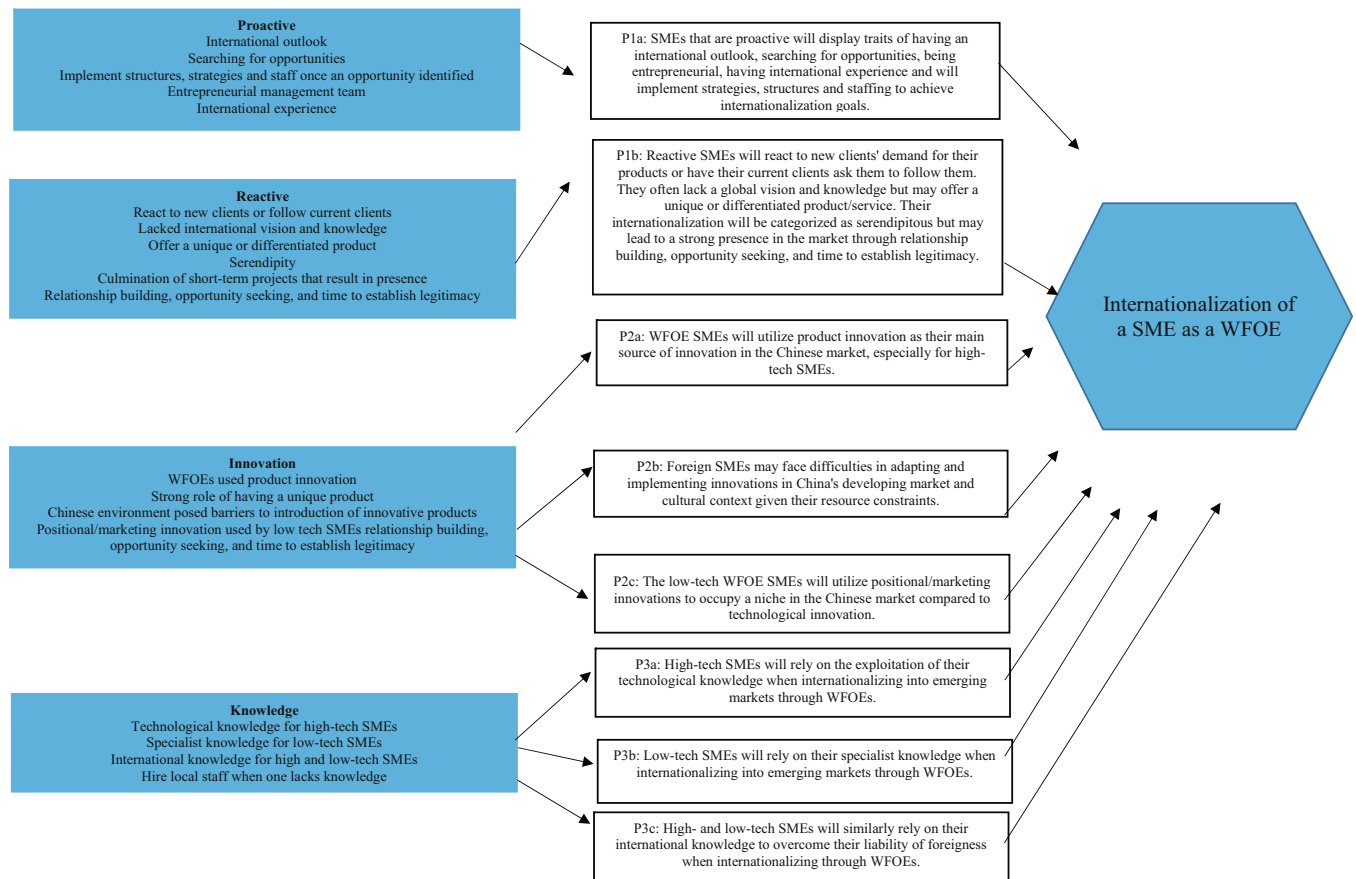


FIGURE 1 How internationalization occurred for Australian SMEs using WFOEs [Color figure can be viewed at wileyonlinelibrary.com]

Driffield, 2011; O'Cass & Weerawardena, 2009; Rodríguez & Rodríguez, 2005), but have rarely explored the lessons that can be drawn from SMEs engaging in more resource intensive entry modes such as WFOEs in emerging markets. Based on the findings of our qualitative research, we develop the following propositions:

P1a: SMEs that are proactive will display traits of having an international outlook, searching for opportunities, being entrepreneurial, having international experience, and will implement strategies, structures, and staffing to achieve internationalization goals.

P1b: Reactive SMEs will react to new clients' demand for their products or have their current clients ask them to follow into international markets. They may lack a global vision and knowledge but offer a unique or differentiated product/service. Their internationalization will be categorized as serendipitous but may lead to a strong presence in the market through relationship building, opportunity seeking, and enough time to establish legitimacy.

The role of innovation for SMEs utilizing WFOEs was also intriguing. It was apparent that most SMEs, especially those in high-tech industries, were mainly using product innovation. However, it was apparent that firms needed to adapt their innovations to the Chinese market, as they were not always accepted. However, adapting to aspects of the firm's products to the Chinese market was not always feasible, given the resource constraints of the SME (Brouthers et al., 2015). The trade-off between standardization and local adaptation is a core underpinning of international strategy theories (Boddewyn, Soehl, & Picard, 1986; Prahalad & Doz, 1987). Our findings suggest that a contingency approach of taking the firm and market context into account is needed, as the decision to standardize or adapt the innovation accordingly is not always simple (Chung, Lu Wang, & Huang, 2012; Quelch & Hoff, 1986). Some SMEs found that Chinese clients/consumers were themselves not keen on innovation, which seemed to be a cultural preference, or considered the adoption of the innovation too economically costly. This means that firms generally need to be wary of whether the innovations they offer can be accepted in emerging markets and whether adaptation is feasible given their limited resources. Our analysis suggests that all fourteen SMEs in our study were successful in their foreign market endeavors despite the challenges associated with operating in a culturally and institutionally different context. However, the acceptance of their innovations varied. Positional/marketing innovation was more apparent for the low-tech SMEs. Based on these findings, we offer the following propositions:

P2a: WFOE SMEs will utilize product innovation as their main source of innovation in the Chinese market, especially for high-tech SMEs.

P2b: Foreign SMEs may face difficulties in adapting and implementing innovations in China's developing market and cultural context, given their resource constraints.

P2c: The low-tech WFOE SMEs will utilize positional/marketing innovations to occupy a niche in the Chinese market rather than technological innovation.

The firm's organizational knowledge (technological or specialist knowledge) and international knowledge (embedded in the managerial team or foreign market employees) enable the firm to navigate foreign markets and identify appropriate opportunities to exploit. We found that technological knowledge was a key enabler for high-tech SMEs developing a physical presence in China, where they sought to stay close to the commercialization of their technology through manufacturing or its service component (e.g., research and clinical trials). We found specialist knowledge to be a vital asset for low-tech SMEs looking to penetrate emerging markets, as it assists these smaller firms in overcoming their liability of smallness by effectively targeting an unoccupied niche (Aldrich & Auster, 1986). Moreover, it serves as a substitute for their lack of technological knowledge (Burgers et al., 2008; Sullivan & Marvel, 2011), and a source of innovation and competitive advantage. Further, international knowledge was found to play a critical role in successful internationalization using high commitment entry modes, where establishing a local presence also allows entrepreneurs to acquire local talent who can help overcome their liability of foreignness (Zaheer, 1995). In light of these findings, we propose the following:

P3a: High-tech SMEs will rely on the exploitation of their technological knowledge when internationalizing into emerging markets through WFOEs.

P3b: Low-tech SMEs will rely on their specialist knowledge when internationalizing into emerging markets through WFOEs.

P3c: High- and Low-tech SMEs will rely on their international knowledge to overcome their liability of foreignness when internationalizing through WFOEs.

6 | LIMITATIONS AND FUTURE RESEARCH

This study is not without limitations. Firstly, although we explored in-depth how SMEs internationalized as WFOEs based on the key themes identified in our analysis, our study was limited to a sample of fourteen SMEs. Hence, future research can benefit from a larger sample size and draw further conclusions by comparing specific industry sectors. Secondly, our data collection methods do not explore performance measures. Our sample facilitates comparison among high-performing and low-performing firms; however, it suffers from survivor bias, that is, all firms we examined were successful in their ventures.

Thirdly, from a theoretical perspective, we do not examine the influence of institutions (e.g., laws, regulations, norms, and culture) and business ecosystems on SME internationalization (Scott, 1995, 1998). We encourage future research to incorporate the influence of environmental forces (e.g., regulations, culture, government intervention, infrastructure, and technological capabilities) when exploring

internationalization strategy in emerging economies (Hess, 2020; Meyer & Peng, 2016). Research can also explore how innovative SMEs adapt, interact, and co-create in emerging market entrepreneurial ecosystems through networks and stakeholder collaborations (Ratten, 2020b). Moreover, future research can extend our conceptual model by incorporating entrepreneurial ecosystems to understand how international entrepreneurs are addressing business challenges related to the COVID-19 pandemic (Ratten, 2020a).

We encourage future researchers to utilize and extend our conceptual model into other countries, as we believe that further insights can be synthesized from exploring other emerging market contexts. Researchers would have the opportunity also to examine the propositions that we developed as hypotheses in a larger sample size and establish in what contexts they hold true. There are also possibilities for extending the theoretical model using these propositions and model in the case of firms from emerging countries investing in developed countries, in the form of outward foreign direct investment (OFDI), as the volume of OFDI from emerging countries has increased substantially (Deng, Yang, Wang, & Doyle, 2017).

7 | CONCLUSION

In light of the evolving business environment in China, innovative SMEs from developed markets are well placed to benefit from the market opportunities available from establishing a physical presence there through a WFOE (Ripollés, Blesa, & Monferrer, 2012; Zahra et al., 2000). However, they also face greater risks in market entry than larger organizations due to their limited resources and lack of experience in overseas markets (Brouthers et al., 2009; Lu & Beamish, 2001). This study sought to explore how SMEs can effectively internationalize through high commitment entry modes and compete successfully in emerging markets. Understanding the key success factors in terms of the manager's entrepreneurial drive, innovative capabilities, and organizational knowledge is essential to increase the likelihood of the successful establishment, growth, and capitalization of foreign market opportunities (Deligianni et al., 2015; Knight & Liesch, 2016; Sapienza et al., 2006).

Our findings demonstrate that the internationalization of innovative SMEs into China is not always driven by a proactive international outlook, as it is sometimes triggered by a reactive response to an opportunity presented by an existing or prospective client or partner. Regardless of the initial driver for internationalization, we found that innovative SMEs must possess the capabilities and resources to capitalize on foreign market opportunities and establish a competitive presence. For high-tech SMEs, this involves capitalizing on their technological knowledge and product innovations to gain and sustain a competitive edge, whereas for low-tech SMEs, it involves targeting an unoccupied niche through specialist knowledge and positional innovation. Although innovation proved critical for the success of these firms, entrepreneurs must be cautious in understanding the local context and limitations of their own resources when making decisions on standardizing existing products or services or engaging in local adaptation. International knowledge proved critical in mitigating the

uncertainty for both types of firms. Such knowledge was either embedded from the accumulated experience of the management team or acquired by employing local talent.

Our research provides vital conceptual narrative evidence to help researchers and practitioners make more effective decisions in terms of market engagement strategies and opportunity realization in the Chinese market. In the study, we addressed calls for examining issues around innovation in the Chinese context (Chatterjee & Sahasranamam, 2018; Heredia et al., 2020), and understanding the capabilities needed for SMEs to succeed in foreign markets under higher commitment entry modes (Welch et al., 2007). With such high potential gains and risks, the need for intelligence-backed action is essential for SMEs to take their share of this dynamic new world of trade.

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