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Growing new MNEs in New Zealand: the FSA/CSA framework revisited
Anna Gerke and Maureen Benson-Rea
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Abstract

Purpose – This article aims to investigate how country location, as a source of country-specific advantage (CSA), and product innovation, as a source of firm-specific advantage (FSA), influence the international expansion of small and medium-sized enterprises (SMEs) and their growth to become multinational enterprises (MNEs). It also aims to confirm internalization theory by testing the applicability of an extant concept, the FSA/CSA framework for the international expansion of SMEs. Developed and empirically validated largely in the context of the MNE, this paper seeks to show how the framework can be applied in the context of SMEs that develop into MNEs.

Design/methodology/approach – A qualitative approach is employed within a single industry setting using multiple cases. Propositions are formulated to explain the theorized relationships between innovation and the growth of SMEs in a sector which depends heavily on specific CSAs. Data were collected through semi-structured interviews and archival data, and are analyzed in data displays, tables and matrices.

Findings – The article finds that location of the industry cases as a source of CSAs, and product innovation as a source of FSAs, are highly relevant for growing New Zealand SMEs into MNEs. The study applies internalization theory to the growth strategies of SMEs.

Originality/value – This research combines extant theory and a specific context in order to analyze phenomena through a distinct conceptual lens. It confirms the CSA/FSA framework by applying it in a new empirical context. It can inform decision-makers in growing SMEs on the strategic and international implications of firm and location advantages.

Keywords Firm-specific advantage, Country-specific advantage, Internalization theory, New Zealand, Small and medium-sized enterprises, International expansion, Product innovation

Paper type Research paper

Introduction

How SMEs grow and develop into MNEs through international expansion

Early international business theory developed from research around large corporations that invest directly in foreign countries (Hymer, 1960). However, small and medium-sized enterprises (SMEs) have increasingly become the focus of international business (IB) research (Miesenbock, 1988). Hymer (1970) and others (Buckley and Casson, 1976, 2003; Rugman, 1986) analyzed how the multinational enterprise/corporation (MNE/MNC) can overcome the imperfections of international markets. IB research addresses the questions why and how firms operate business activities across national boundaries (Wright, 1970). A number of directions in IB research have developed from this (Coviello and McAuley, 1999): foreign direct investment (FDI) (Buckley and Casson, 1998; Dunning, 2000; Rugman, 1986); process models (Johanson and Vahlne, 1977; Johanson and Wiedersheim-Paul, 1975); the “born global” model (Oviatt and McDougall, 1994; Weerawardena et al., 2007); the network model (Chetty and Blankenburg Holm, 2000; Johanson and Vahlne, 2009); and
international entrepreneurship (Coombs et al., 2009; Rialp et al., 2005). The more recent research areas are approaches that extend or link back to older models, or which overlap with them. Johanson and Vahlne (2009), for example, consider the network approach as a further development of the process model.

Research on FDI has been primarily been concerned with the MNE/MNC as the unit of analysis (Dunning, 1980; Dunning and Lundan, 2010), while more recent approaches analyze its role in the internationalization of SMEs (Chetty and Blankenburg Holm, 2000; Li et al., 2004; Wright et al., 2006). Dunning and Lundan (1993) define MNEs as enterprises that engage in FDI, which enables them to own and control value-adding activities in two or more countries (Dunning, 1993), through different modes, including equity-based modes (Buckley and Casson, 1998; Root, 1994). Equity-based FDI is generally undertaken by large MNEs, while the most common forms of FDI by SMEs are contractual agreements, such as licensing (Hollenstein, 2005). The research area of FDI includes the timing of market entry, motivation for FDI, choice of location and entry mode, consequences of FDI for home and host country, and for the firms in those countries (Werner, 2002). Although FDI has been studied in the context of SMEs (Brouthers et al., 1996), the majority of FDI research is concerned with MNEs as the units of analysis (Dunning and Lundan, 1993). However, there is a growing trend to consider SMEs in IB research by analyzing how they can grow to become MNEs and under what settings, conditions and influence factors (Coviello and McAuley, 1999; Fillis, 2001; Hollenstein, 2005).

The FSA/CSA explanation of international growth
Researchers in the area of FDI (Dunning, 1980, 2001; Rugman, 1980, 1981) developed theories that explain international production and FDI, in which MNEs internationalize in order to internalize market imperfections (Rugman, 1980). Dunning’s eclectic or OLI paradigm explains that whether, and to what extent, a firm engages in FDI depends on three factors (Dunning, 1980):

1. ownership of assets or access to assets which its competitors or potential competitors do not possess;
2. interest and ability in the internalization of these assets, i.e. making use of them rather than selling or leasing them to others; and
3. location based factors that influence the profitability of exploiting the firm’s assets in a foreign country versus in the home country.

Rugman (1986) takes this approach further by combining the first two factors, ownership and internalization, into firm-specific advantage (FSA) and labeling the third factor country-specific advantage (CSA) in the FSA/CSA framework (Rugman, 2010). Both models have been used to explore international business activities of firms, and in this study we apply the FSA/CSA framework to the international growth strategy of SMEs.

The original notions of the FSA/CSA concept can be traced back to long before it was labeled as such. The underlying concept of CSAs developed more than 50 years ago, when national competitiveness at country level was the unit of analysis in IB research. The main idea was that countries hold competitive advantages (e.g. resources) above others, namely CSAs, which can be leveraged from other countries, as advanced by the “double diamond” model (Rugman and D’Cruz, 1993; Rugman and Verbeke,
A few decades later, the notion that firms possess specific advantages that differentiate them from others came together with the concept of the MNE that engages in FDI (Dunning, 1980; Rugman, 1980, 1986). FSAs are closely linked to the MNE as the unit of analysis and more recently to the subsidiary of a MNE as a third major unit of analysis in IB research (Rugman et al., 2011). FSAs have been further conceptualized by clustering them into three different types: stand-alone FSAs, routines, and recombination capabilities (Verbeke, 2009; Hennart, 2009; Verbeke and Yuan, 2010; Rugman et al., 2011). Stand-alone FSAs are independent from other factors and inherent to the individual firm, and routines are accustomed behaviors inside a firm. Recombination capability refers to whether a firm is able to link extant internal resources (FSAs) with new external resources (CSAs) in order to ameliorate their resource base (Verbeke, 2009). In this research we focus on one particular type of stand-alone FSAs, namely, product innovation capabilities as an independent and inherent competence of the firm.

We build on previous research into understanding the distinct contributions of country- and firm-level advantages by explicitly examining the heterogeneity of performance and development in a sample of firms within the same industry sector internationalizing from the same location. Similar approaches have recently investigated firm-specific and country-specific advantages of US biopharmaceutical SMEs and their influence on firm internationalization (Li et al., 2011) and the applicability of internalization theory (particularly FSAs) in the context of SMEs in Newly-Industrialized Economies (Chiao et al., 2006). The CSAs of Korea in the case of Korean SMEs and their adoption of e-business is analyzed by Jeon et al. (2006), and Lefebvre (2001) examines innovative capabilities as a source of FSAs and how these influence export performance and behavior of manufacturing SMEs. The most appropriate mode of entry for SMEs based on their country- and firm-specific advantages is studied in over 170 Canadian SMEs and their international activities in 12 Pacific Rim countries (Dhingra, 1991). Rugman and Sukpanich (2006) investigate four firm-specific advantages (firm size, knowledge (R&D), marketing ability, and industry type) and their role for firm performance. In a recent study, firm-specific advantages are analyzed with regard to the motivation and strategy of UK exporters (Beleska-Spasova and Glaister, 2011).

The context for our study is New Zealand-based SMEs in the outdoor sport goods industry. Two factors as possible antecedents for the international expansion of SMEs are analyzed based on Rugman’s (1981, 2009) model of country- and firm-specific advantages. The roles of New Zealand as a source of CSAs and product innovation as a source of FSAs with regard to a firm’s international expansion towards MNE status are examined. The paper proceeds as follows. First, we develop some propositions on the roles of FSAs and CSAs in the international growth of smaller firms. Then, we describe the industry setting for our data collection, and our methods. We then set out and discuss our findings and draw conclusions on the propositions. Areas for further research and limitations conclude the paper.

**Proposition development**

*Country-specific advantages drive international growth*

The internationalization of different parts of the value chain and targeting sales in markets outside the domestic context are a common development path for SMEs...
seeking long-term growth and survival in an increasingly globalized marketplace (Smeral, 1998). This holds especially true for firms that seek to grow from a geographically isolated country such as New Zealand, which depends on exports because of its limited domestic market size (Benson-Rea and Mikic, 2005; Simmons, 2002). International expansion is important for New Zealand firms in order to cope with international competition and to overcome what has been called New Zealand’s “Tyranny of Distance”, an expression that encapsulates New Zealand’s geographical isolation (Chadee and Cartwright, 2002). To investigate the role of the home location for a firm’s international expansion, we look first at its specific characteristics.

New Zealand is renowned for its “clean and green” natural environment, its supply of natural raw materials and its geographical diversity that offer opportunities for a large variety of outdoor activities (SPARC, 2008). Such activities play a major role in the social life of New Zealand, to the extent that its cultural identity is often closely linked to recreational leisure activities outdoors (Bergin, 2002; Perkins and Gidlow, 1991). These location-bound characteristics have built a national “Brand New Zealand” (SPARC, 2008). Inspired by unique geographical and lifestyle conditions and culture, innovative New Zealand firms have developed that design and manufacture unique sport apparel and equipment (New Zealand Marine Industry, 2010; New Zealand Trade and Enterprise, 2008). International niche brands (Benson-Rea and Shepherd, 2008, 2010) have emerged, such as Canterbury, Icebreaker, Kathmandu, Macpac, OBO and Orca, whose brand values originate from and are strengthened by New Zealand’s global contributions in such activities as rugby, yachting, hockey and mountaineering. New Zealand’s economy is based heavily on trade in marine and land-based commodities (Akoorie et al., 1993), though Benson-Rea and Mikic (2005) argue that New Zealand firms need to focus on innovation and technology intensive products and services in order to exploit international opportunities. Strategies built on FSAs/CSAs could grow new MNEs in New Zealand’s outdoor sport goods industry and offshore activities that could foster the increased development of this industry. Furthermore, the geographical concentration of firms from related industries support the cluster-building, which can result in a sustainable source of CSAs (Akoorie and Scott-Kenell, 2005; Glass and Hayward, 2001; Porter, 1998a).

A fundamental proposition underpinning our research is that New Zealand – as a location – is a source of CSAs for firms in the outdoor sport goods industry. It is suggested that these CSAs impact positively on the international expansion and growth of local firms. Benefits arise for growing companies from being located within an industry cluster, since cluster structures foster strong industries or sectors and enhance the reputation of a location in a particular field or product. This enables firms to compete internationally in such a niche (Porter, 1998a). Industry associations in New Zealand argue that a benefit for New Zealand-based firms is the “clean and green” image of New Zealand – the source of “Brand New Zealand” – which strengthens the market positioning of New Zealand made products (SPARC, 2008). Further, New Zealand’s unique natural resources and environment (such as, amongst others, the maritime infrastructure, the unspoiled outdoor environment, and the merino sheep) provide favorable conditions to develop and test new outdoor sport products. These products are often considered superior compared with those from overseas (New Zealand Marine Industry, 2010; Textiles NZ, 2010) since they have been developed for
Firm-specific advantages drive international growth

Previous studies have linked innovation and internationalization in different industry contexts and research questions. In the service sector, Meliá et al. (2010) found evidence that an innovation orientation accelerates the pace of internationalization and influences the entry mode decision. Rammer and Schmiele (2009) found that experience and knowledge protection influence the drive for internationalization of German SMEs through innovation. Some researchers have investigated the benefits of internationalization on product innovation (Kleinschmidt and Cooper, 1988; Zahra et al., 2009), inverting the research question towards how internationalization influences innovation. Indeed, Cavusgil and Kirpalani (1993) set out a research agenda to investigate success factors in international product entry, comparing new products with existing products, and SMEs with MNEs. In studies of innovation in specific industries, Desbordes (2002) found identifiable evolutionary patterns in the industry life cycle relative to innovation in sports equipment, and Andersson (2004) identified distinct variations in the internationalization of firms in different industrial contexts, especially as between new and mature industries. Furthermore, product innovation is an important driver for the international success of small firms that specialize in niche industries, and specialization can enable them to become leading providers of deep niche products (Benson-Rea and Shepherd, 2010; Fujita, 1995). Strategies to specialize in high value and differentiated niche products through innovation are critical if New Zealand firms are to grow and remain competitive at a global level in the long-term (Boven et al., 2010). Based on these previously identified factors, we suggest the following:

\[
\text{H2a. Product innovation is a source of FSAs which facilitate and foster international expansion of New Zealand-based firms.}
\]

\[
\text{H2b. New Zealand-based firms that build their strategy on product innovation as a source of FSAs are highly internationalized.}
\]
Our multiple case study is used in an explanatory way to confirm existing theory (Burawoy, 1991) by “combining context sensitivity with explanatory rigor” (Welch et al., 2011, p. 757). Our exploratory, open inquiry was conducted inductively (Bryman and Bell, 2003) from an interpretivist position, assuming that reality is subjective and that the perception of reality depends on those who live in it. Since such knowledge can only be created and understood with individuals who belong to and participate in the research setting (Denzin and Lincoln, 2005), the observed phenomena are inseparable from the individuals involved in them (Bryman and Bell, 2003). Our sample selection was based on three criteria:

1. indigenous firms from New Zealand to control for location effects;
2. firms with fewer than 500 employees to fulfill the SME condition[1]; and
3. firms whose core business is related to the design, manufacture and/or marketing of outdoor sport goods from the yachting or outdoor clothing sector.

Each sector is represented by five theoretically selected firms (Eisenhardt, 1989). The unit of analysis is the outdoor sport goods industry in New Zealand, with two sub-sectors and five cases within each sub-sector. The interviewees in each firm are the major source of primary data. Figure 1 illustrates the multiple case study research design showing the different levels of context and the respective cases, indicated by size (as measured by relative sales volume).

**Data collection**

The data were collected from three sources:

1. semi-structured interviews with the CEO, GM or an equivalent decision-maker in the firm;
2. *ex ante* and *ex post* requests via phone or email for clarification of issues and review of the individual case findings; and
3. archival data, including firm websites, business publications, firm brochures, case studies, websites of trade organizations and shows, and other materials provided by the informants or publicly available.

![Figure 1. Multiple case study research design](image-url)
The main data source was semi-structured interviews with the key decision-maker of the firm. A total of ten interviews with ten different representatives from ten different firms were conducted over a period of two months. The interviews ranged from 30 to 90 minutes in duration. They were all conducted face-to-face, except one video call, by the first author. A semi-structured interview guide (see Appendix 1) was used, which was subdivided into four sections. The first section focused on the firm itself, the second on the industry and sector in which the firm was engaged, the third on the influence of product innovation on international expansion, and the fourth on the relevance of New Zealand as a location for the international expansion of the sample firm. The cases were selected according to the research context for theoretical reasons rather than for statistical reasons, i.e. the selected cases seemed likely to exhibit the investigated phenomenon (Eisenhardt, 1989). However, attention was paid to selecting a diversity of firms in terms of size and core business within the sub-sector.

Data analysis
As an accepted method within inductive research Graebner (2004) and Eisenhardt (1989) suggest building individual case studies as a first step in data analysis and subsequently comparing them to identify patterns and concepts. The individual case studies relate to the within-case analysis. They are descriptive and essential for the ensuing across-case analysis (Eisenhardt, 1989). In order to increase the reliability of the information gathered, the case write-ups were sent to the interviewees to review and confirm. The manual data analysis sought to identify similar patterns or themes in each case firm’s international business development. The first theme was the dependence of a firm’s international expansion on New Zealand as a source of CSAs. The second explored the influence of product innovation as a source of FSAs on the firm’s international expansion. The pattern for across-case analysis were determined by the level of context mentioned above. The first across-case analysis was conducted comparing the five cases within each sub-sector. We searched for indicators that confirmed that New Zealand as location was a source of CSAs and that product innovation was a source of FSAs. We investigated whether those advantages facilitated and fostered international expansion of the firms. Second, we used the results from the cross-case analysis within a sector and compared the results across the two sub-sectors, i.e. within the industry. Our findings are presented using visual displays, tables and graphics.

Cases and findings
We first give an overview with the key data in terms of internationalization for each case to introduce the firms briefly. This includes timing and mode of internationalization (Buckley and Casson, 1998; Root, 1994), generic strategy (Porter, 1998b), internationalization process (Chetty and Campbell-Hunt, 2004; Coviello and McAuley, 1999; Li et al., 2004), and intensity of international sales (Rugman and Verbeke, 2004). We select one example in each sub-sector to present a within-case analysis. This summarizes not only the data collected, but examines the roles of New Zealand as a source of CSAs and product innovation as a source of FSAs. Last, we discuss whether a link between the respective CSAs or FSAs and the firm’s international expansion can be identified in that particular case. Pseudonyms have been used to protect the companies’ identities.
The yachting sector

Five firms in the yachting sector were interviewed. The selected firms include boat-builders of different boat types and boat component builders. Table I summarizes the key data of the sample firms in this sub-sector.

Case example: Sigma

Sigma was founded in 1989 and has specialized in the design, manufacture and distribution of masts and rigging. Initially, Sigma manufactured in New Zealand and started exporting soon after its inception, and subsequently founded subsidiaries for services and sales in key markets such as the US, Europe, and South Africa. More recently, Sigma has established production facilities in three foreign locations in order to serve different markets more efficiently. In doing so, Sigma is responding to pressures of local responsiveness and cost reduction simultaneously. The output of production facilities in locations with lower labor costs serves to target broad, low-end markets with standardized products. The production facilities in high-end markets serve specific middle to high-end customers with custom products. Hence, Sigma is pursuing a differentiation strategy in terms of the high-end segment, and a cost leadership strategy with regards to the low-end segment. The nature of initial growth was organic as international sales increased. The recent international expansion with regards to production was achieved through inorganic growth by mergers and acquisitions. Sigma’s specific niche market is very discrete with few competitors, and Sigma is clearly the market leader in its core business, high-end custom masts, with around 90 percent market share.

Sigma believed that New Zealand as a location had not been particularly relevant to the firm’s initial development or the following growth and international expansion. This was expressed by Sigma’s General Manager:

I wouldn’t say it [New Zealand as location] was an advantage, and it’s only very occasionally that it’s a disadvantage (General Manager at Sigma).

Nowadays the headquarters, located in New Zealand, play a vital role for Sigma as the design and R&D team is based there. R&D is not only visible in Sigma’s products, but also in employee numbers. In total, 25 employees work full-time on the improvement of technology and design of its products. Sigma estimates that, in the high-end custom masts segment, around 40 employees are occupied with R&D and design activities worldwide. Hence, Sigma employs over 50 percent of the innovative personnel in its core segment.

<table>
<thead>
<tr>
<th>Firm</th>
<th>Lambda</th>
<th>Sigma</th>
<th>Rho</th>
<th>Psi</th>
<th>Omega</th>
</tr>
</thead>
<tbody>
<tr>
<td>No of employees</td>
<td>440</td>
<td>350</td>
<td>50</td>
<td>25</td>
<td>1</td>
</tr>
<tr>
<td>Total sales $NZ million&lt;sup&gt;a&lt;/sup&gt;</td>
<td>&gt;100</td>
<td>&gt;100</td>
<td>50 &lt; 100</td>
<td>1 &lt; 5</td>
<td>0 &lt; 1</td>
</tr>
<tr>
<td>Total sales exported (%)</td>
<td>100</td>
<td>100</td>
<td>40</td>
<td>60</td>
<td>100</td>
</tr>
</tbody>
</table>

Table I. Profile of case firms in the yachting sector

*Note:* For confidentiality reasons, sales volume is presented in ranges: 0 < 1, 1 < 5, 5 < 20, 20 < 50, 50 < 100, > 100 (in $NZ million)
Sigma considers product innovation as a major driver of its business. Sigma has introduced many firsts into the global yachting sector, which have been rewarded with international design or boat show awards. Product innovation activities include design, technology and material, as revealed in the following statement:

[...] we’ve got a dedicated technology group that is looking at R&D in terms of materials, production processes and technologies (General Manager at Sigma).

Furthermore, process innovation aims at the continuous improvement of production processes in terms of accuracy and efficiency. As New Zealand as a source of CSAs was not particularly relevant for Sigma, it had not significantly influenced Sigma’s international expansion. Sigma confirmed that product innovation as a source of FSAs was and is a major driver for international growth and expansion of Sigma. The uniqueness of Sigma’s products, which was achieved through on-going product innovation in terms of design, technology and material, attracted customers from everywhere. Hence, product innovation facilitated and fostered the international expansion of Sigma’s customer base and, furthermore, led to the internationalization of production activities.

Across case findings in the yachting sector
Findings on the internationalization of the cases are summarized in Table II. Three of the five case firms had internationalized their business early, with four using direct export as entry mode. As generic strategies, the firms primarily pursued differentiation and differentiation focus. The internationalization process was primarily incremental, and the export intensity was very high for three of the five firms.

New Zealand was analyzed as a source of CSAs and the findings are summarized in Table III. The table lists reasons why New Zealand was seen as a source of CSAs for each firm. These factors draw on Porter’s (1998a) cluster theory and insights from the interviews. “Yes” indicates that the point applies to the case firm, while “No” indicates the opposite. The overall judgment on whether a firm viewed New Zealand as a source of CSAs was done by synthesizing the evidence from the interview responses for each case. The answer that predominated was interpreted as the key indicator. Three firms considered New Zealand as a source of CSAs, two firms did not.

The role of product innovation as a source of FSAs is discussed and the findings are summarized in Table IV. The table shows reasons why product innovation was seen as a source of FSAs for each firm. These factors are drawn from insights from the interviews. “Yes” indicates that the point applies to the case firm, while “No” indicates the opposite. The overall judgment on whether a firm viewed product innovation as a source of FSAs was done by synthesizing the evidence from the interview responses for each case. The answer that predominated was interpreted as the key indicator. Three firms considered product innovation as a source of FSAs, while for two it was not important.

Table V summarizes the overall findings, showing whether there were indicators that international expansion of the firms was fostered by the location New Zealand as a source of CSAs and/or product innovation as a source of FSAs for those firms that confirmed these factors. The judgment on whether a firm that viewed New Zealand as a source of CSAs and/or product innovation as a source of FSAs confirmed these as a driver for international expansion was done by synthesizing the evidence from the
### Table II.
Internationalization of case firms in the yachting sector

<table>
<thead>
<tr>
<th>Case</th>
<th>Timing</th>
<th>Entry mode</th>
<th>Strategy</th>
<th>Process</th>
<th>Export intensity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lambda</td>
<td>Early</td>
<td>Direct export</td>
<td>Differentiation focus</td>
<td>Incremental</td>
<td>Very high</td>
</tr>
<tr>
<td>Sigma</td>
<td>Early</td>
<td>Direct export</td>
<td>Differentiation focus</td>
<td>Incremental</td>
<td>Very high</td>
</tr>
<tr>
<td>Rho</td>
<td>Following</td>
<td>Direct export</td>
<td>Differentiation focus</td>
<td>Incremental</td>
<td>High</td>
</tr>
<tr>
<td>Psi</td>
<td>Early</td>
<td>Direct export</td>
<td>Differentiation focus</td>
<td>Incremental</td>
<td>Very high</td>
</tr>
<tr>
<td>Omega</td>
<td>Early</td>
<td>Direct export</td>
<td>Differentiation focus</td>
<td>Incremental</td>
<td>Very high</td>
</tr>
</tbody>
</table>

Note: 
- **Timing**: Early = Within five years after inception; Following = Five to ten years after inception; Late = More than ten years after inception.
- **Entry mode**: Direct export = Enters a country via export.
- **Strategy**: Differentiation focus = Competitive strategy based on Porter's generic competitive strategy model.
- **Process**: Incremental = Incremental model (Uppsala) versus born-global model.
- **Export intensity**: Very high = 75-100 percent; High = 50-74 percent; Low = 25-49 percent; Very low = 0-24 percent.
The answer that predominated was interpreted as the key indicator. Three firms identified that the location New Zealand as a source of CSAs drove the firm’s international expansion. Three firms indicated that product innovation was a source of FSAs that fostered the firm’s international expansion. Two firms indicated both New Zealand as source of CSAs and product innovation as source of FSAs influenced internationalization positively. One firm considered neither aspect very important to the business and its international expansion.

The outdoor clothing sector

Five firms in the outdoor clothing sector were interviewed. The selected firms have grown their core business around one specific sport discipline or clothing material and expanded from there. Table VI summarizes key data of the interviewed firms.
Case example: Epsilon

Epsilon was founded in 1995 and specializes in the design, manufacturing and distribution of merino wool clothing. Initially, the firm started in the outdoor segment, but other segments have now been added, such as snow sports, running, biking and active fashion. Hence, Epsilon’s product range has evolved from 30 items in Epsilon’s first year to 1,000 garments in 2010. International expansion of Epsilon’s markets started soon after the firm’s inception in incremental steps, moving from close geographical and psychic markets, such Australia and the UK, to more distant markets in Europe, the US, and Asia. Epsilon’s business model focused on design and marketing, while resources were obtained primarily in New Zealand (merino wool) and the US (accessories), and production was outsourced to an Asian manufacturer. However, Epsilon kept a tight control on the quality and work standards of their partners. Export was initially handled through external distributors, though the model changed towards its own sales subsidiaries in key markets. These were established through foreign direct investment and acquisitions at a later stage of internationalization.

Epsilon’s consideration of New Zealand as location was relevant for different reasons. Its main argument was that Epsilon’s products were made of merino wool that was uniquely grown and sourced in New Zealand due to its outstanding quality. This paradigm was a core part of the firm’s business model and marketing strategy. Closely connected to the merino sheep as the source and origin of the firm was the firm’s philosophy of the relationship between humans and nature, and to each other. New Zealand was often the location for visualizing this message in photographs for Epsilon’s marketing communications material. Epsilon believed that New Zealand’s reputation for the outdoors had helped to increase international sales in the outdoor segment, as indicated in the following quote:

[...] it’s an easy logic to follow that, you know a brand that comes from New Zealand really understands the outdoors (General Manager at Epsilon).

However, Epsilon pointed out that New Zealand as a location was not very important in order to succeed in other segments of Epsilon’s target market, such as running apparel or active fashion. New Zealand was furthermore important as the source of loyal employees and for support through export and trade associations, such as the national trade promotion body, New Zealand Trade and Enterprise (NZTE).

Product innovation has been a core competency of Epsilon since the very beginning. Epsilon was the first firm to introduce merino clothing as a technical performance

<table>
<thead>
<tr>
<th>Year of inception</th>
<th>Epsilon</th>
<th>Beta</th>
<th>Alpha</th>
<th>Delta</th>
<th>Gamma</th>
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<tr>
<td>No of employees</td>
<td>250</td>
<td>43</td>
<td>18</td>
<td>5</td>
<td>1-2</td>
</tr>
<tr>
<td>Total sales $NZ million²</td>
<td>&gt;100</td>
<td>5 &lt; 20</td>
<td>5 &lt; 20</td>
<td>1 &lt; 5</td>
<td>0 &lt; 1</td>
</tr>
<tr>
<td>Total sales exported (%)</td>
<td>80</td>
<td>5-10</td>
<td>90</td>
<td>60</td>
<td>50</td>
</tr>
</tbody>
</table>

Table VI. Profile of case firms in the outdoor clothing sector

Note: ²For confidentiality reasons, sales volume is presented in ranges: 0 < 1, 1 < 5, 5 < 20, 20 < 50, 50 < 100, > 100 (in $NZ million)
garment in the outdoor clothing segment and has subsequently been cutting-edge in
many ways in this sector. Epsilon focused its product innovation in design in terms of
color and trim, and on material innovation in terms of the way the fabric is knitted and
the fabric mixture. Epsilon’s clothing usually consists of 100 percent merino, but just
recently the firm launched garments that consist of a mixture of merino and a small
amount of Lycra. Product innovation was driven by the urge to penetrate new markets
in terms of customer segments, as emphasized in this quote:

It’s more about consumers than it is about geographies when it comes to innovation (General
Manager at Epsilon).

Beginning in the outdoor segment, Epsilon is now exploring other segments, such as
run, bike, snow sports and active fashion. These new segments were targeted
independent of geographical location, as major markets such as Europe, the US, and
Asia had been entered. However, sales growth in individual markets differed
depending on how distinctive the target group in each segment was.

Overall, Epsilon believed that product innovation served business growth in
general. As 80 percent of Epsilon’s markets are outside of the domestic market,
international sales have been pushed by product innovation. However, this did not
happen as an intentional strategic move, but rather naturally due to the international
distribution of Epsilon’s sales.

After initial growth in the domestic market, Epsilon has looked for further growth
opportunities overseas. However, product innovation was usually pursued with the
aim to penetrate new target groups in terms of product segments. As Epsilon’s greater
potential for growth was in larger markets overseas, product innovation had increased
international sales. However, this was not intentionally to foster international growth,
but rather to increase sales in general, which happened to be more and more overseas.

*Across case findings in the outdoor clothing sector*

Findings in terms of the internationalization of the cases are summarized in Table VII.
Four out of the five firms internationalized early. All of them started with indirect
export, and the predominant strategy was differentiation with a focus on niche
markets. The international expansion happened for four firms incrementally, and the
export intensity for four of the firms was high or very high.

Reasons for viewing New Zealand as a source of CSAs and product innovation as a
source of FSAs were investigated in the same way as for the yachting sector. The
tables list the same reasons why New Zealand is a source of CSAs and product
innovation a source of FSAs. The data analysis was conducted in the same way,
analyzing whether a point applied to the respective firm and summarizing the results
using the majority approach. Three of the five firms indicated that being from New
Zealand was a CSA for them, while for two it was not important. All firms viewed
product innovation as crucial to them and hence, a source of FSAs.

Table VIII summarizes the overall findings, showing whether there were indicators
that international expansion of the firms was fostered by the location New Zealand as a
source of CSAs or product innovation as a source of FSAs for those firms that
confirmed these factors. The judgment on whether a firm that viewed New Zealand as
a source of CSAs and/or product innovation as a source of FSAs confirmed these as a
driver for international expansion was done by synthesizing the evidence from the
<table>
<thead>
<tr>
<th>Case</th>
<th>Epsilon</th>
<th>Beta</th>
<th>Alpha</th>
<th>Delta</th>
<th>Gamma</th>
</tr>
</thead>
<tbody>
<tr>
<td>Timing(^a)</td>
<td>Early</td>
<td>Early</td>
<td>Early</td>
<td>Late</td>
<td>Early</td>
</tr>
<tr>
<td>Entry mode</td>
<td>FDI (acquisition and wholly owned subsidiaries)(^b)</td>
<td>Direct export(^c)</td>
<td>Indirect export via distributor</td>
<td>Indirect export via distributor</td>
<td>Indirect export via distributor</td>
</tr>
<tr>
<td>Strategy(^d)</td>
<td>Differentiation focus</td>
<td>Differentiation focus</td>
<td>Differentiation focus</td>
<td>Differentiation focus</td>
<td>Differentiation focus</td>
</tr>
<tr>
<td>Process(^e)</td>
<td>Incremental</td>
<td>Incremental</td>
<td>Incremental</td>
<td>Incremental</td>
<td>Born global</td>
</tr>
<tr>
<td>Export intensity(^f)</td>
<td>Very high</td>
<td>Very low</td>
<td>Very high</td>
<td>High</td>
<td>High</td>
</tr>
</tbody>
</table>

**Note:**
- \(^a\) Early = Within five years after inception; Following = Five to ten years after inception; Late = More than ten years after inception;
- \(^b\) The initial mode was indirect export via distributor; the company changed the model just recently in 2010;
- \(^c\) The initial mode was indirect export via distributor; the company changed the model just recently in 2010;
- \(^d\) Business-level strategy based on Porter’s generic competitive strategies: cost leadership, differentiation, cost focus, differentiation focus (Porter, 1998b);
- \(^e\) Incremental model (Uppsala) versus born-global model;
- \(^f\) International share of sales: Very high = 75-100 percent, High = 50-74 percent, Low = 25-49 percent, Very low = 0-24 percent
interview responses for each case. The answer that predominated was interpreted as the key indicator. For three firms indicators were identified that the location New Zealand as a source of CSAs drove firm internationalization. All five firms indicated that product innovation was a source of FSAs that fostered the firm’s international expansion. Three firms considered both New Zealand as a source of CSAs and product innovation as a source of FSAs that influenced internationalization positively. Two firms considered only product innovation as a source of FSAs and relevant to the business and its international expansion.

_Across case findings in the outdoor sport goods industry_

Table IX summarizes the results from both industries showing each firm, and both the yachting sector and the outdoor clothing sector. Six out of the ten case firms viewed New Zealand as a source of CSAs and one of the drivers for international expansion of the firm. Out of the ten firms, eight considered product innovation as a source of FSAs and one of the antecedents for international expansion of the firm.

Table X summarizes the results by sector and shows differences between the sectors. The results for New Zealand as a source of CSAs were similar across the sectors, with the profile of three firms supporting _H1a_, while the other two did not. The situation was different for _H2a_, which was supported by all firms in the outdoor clothing sector, but only by three in the yachting sector. There were also differences across the sectors with regards to firms whose data supported both propositions (two in the yachting sector, three in the outdoor clothing sector) and firms that supported neither proposition (one in the yachting sector, none in the outdoor clothing sector). Table X furthermore shows that more firms considered product innovation as a source of FSAs.

<table>
<thead>
<tr>
<th>Case</th>
<th>Lambda</th>
<th>Sigma</th>
<th>Rho</th>
<th>Psi</th>
<th>Omega</th>
<th>Epsilon</th>
<th>Beta</th>
<th>Alpha</th>
<th>Delta</th>
<th>Gamma</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>CSA NZ</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>6</td>
<td>4</td>
</tr>
<tr>
<td>FSA PI</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>8</td>
<td>2</td>
</tr>
</tbody>
</table>

Table IX. Summary of results across cases per case

<table>
<thead>
<tr>
<th>Case</th>
<th>NZ as CSA supported</th>
<th>NZ as CSA not supported</th>
<th>PI as FSA supported</th>
<th>PI as FSA not supported</th>
<th>NZ as CSA + PI supported</th>
<th>Neither supported</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yachting</td>
<td>3</td>
<td>2</td>
<td>3</td>
<td>2</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>Outdoor clothing</td>
<td>3</td>
<td>2</td>
<td>5</td>
<td>0</td>
<td>3</td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td>6</td>
<td>4</td>
<td>8</td>
<td>2</td>
<td>5</td>
<td>1</td>
</tr>
</tbody>
</table>

Table X. Summary of results across cases per sector
of FSAs (eight firms) than those that considered New Zealand as a source of CSAs (six firms). Across the sectors, five cases supported both propositions.

Figures 2 and 3 illustrate the findings graphically and illustrate to what extent the $H1b$ and $H2b$ were confirmed. Figure 2 shows the relationship between the level of international expansion of the firms and the relevance of New Zealand as a source of CSAs. The $x$-axis presents the internationalization of the firm based on the export intensity, i.e. the international sales share of each firm. The scale ranges from very high (75-100 percent international sales), medium (50-74 percent international sales), low (25-49 percent international sales), to very low (0-24 percent international sales). The $y$-axis represents the relevance of New Zealand as a source of CSAs. The scale ranges from less relevant to highly relevant with ten incremental values. The values relate to the data outlined in the tables before and are aggregated to position the firm in Figure 2. Four cases showed support for $H1b$ as they are located in the right upper quarter of the graphic, which represents firms that base their strategy on New Zealand as a source of CSAs and that are highly internationalized at the same time.

Figure 3 shows the relationship between the level of international expansion of the firms and the relevance of product innovation as a source of FSAs. The $x$-axis presents again the internationalization of the firm based on the export intensity. The $y$-axis represents the relevance of product innovation as a source of FSAs. The scale ranges from less relevant to highly relevant with ten values. The values relate to the data set out in the tables before and, again, are aggregated to position the firm in Figure 3. There are six cases that support $H2b$, as they are located in the right top quarter of the graphic, which represents firms that base their strategy on product innovation as a source of FSAs and that are highly internationalized at the same time.
Discussion and conclusions

Our results suggest that New Zealand as a location is indeed relevant as a source of CSAs for the international expansion of New Zealand firms and their growth towards becoming MNEs, thus supporting $H1a$. However, the relevance of New Zealand as a source of CSAs varies between the firms and sectors. Furthermore, those firms that view the location New Zealand as a source of CSAs, on which they base their strategy, tend to be highly internationalized. Hence, $H1b$ is supported.

Second, the results suggest a strong link between product innovation as a source of FSAs and the international expansion of a firm; therefore, $H2a$ is also supported. There are strong indicators that firms that base their strategy on product innovation as source of FSAs are highly internationalized. This supports $H2b$. Product innovation is a significant factor in developing MNEs from SMEs in a small country such as New Zealand.

The propositions have been analyzed and confirmed in two sectors (yachting and outdoor clothing) of a single industry, the outdoor sport goods industry. New Zealand as source of CSAs is equally important in both sectors. Product innovation as source of FSAs is more important in the outdoor clothing sector as a growth factor than in the yachting sector.

These findings seem to imply that SMEs that analyze, consider and explore the unique characteristics of their location with regards to their industry may perform better when growing the business internationally and towards becoming an MNE. As conceptualized by Dunning (2001) and Rugman (2009), the location of a firm holds CSAs that influence the international expansion of that firm. It is important to analyze a firm’s location with regards to its industry in order to identify benefits that arise from
the location and to exploit them with regards to international growth. It is also important to conduct this location analysis with regards to the industry in order to identify whether the firm should be bound to the particular country as location or not.

Furthermore, firms that score high in product innovation are likely to be successful in internationalizing their markets and to develop towards an MNE. This is because they are able to develop high quality and specialized niche products that are able to compete in a global market or that can be supplied to niche target groups all over the world. This proposition is supported by earlier research finding that firms engaging in R&D perform better than those that do not (Benson-Rea and Shepherd, 2010; Fujita, 1995).

Similar studies analyzing location-specific and firm-specific advantages have been conducted using either Dunning’s OLI paradigm (Dunning and Lundan, 2010) or Rugman’s FSA/CSA framework (Rugman, 2009), but these have predominantly been using the context of MNEs (Dunning, 2000; Rugman and McIvreen, 1985; Rugman and Sukpanich, 2006). However, these concepts have found applicability in the SME context as well (Brouthers et al., 1996). Recent studies that explore the peculiarities of SME internationalization, as opposed to the MNE, have taken different approaches, as in, for example, Buckley (1989), Li et al. (2004), and Chetty and Blankenburg Holm (2000). Chetty and Campbell-Hunt (2003) focused on pathways of internationalization for New Zealand-based firms in particular.

The role of New Zealand as a location for internationalizing businesses has been highlighted by a number of researchers (Akoorie et al., 1993; Benson-Rea and Mikic, 2005; Hamilton and Dana, 2003). Desbordes (2002) emphasized product innovation in the context of the sports equipment industry within a particular location. A number of research and case studies have been focusing on successful New Zealand firms in the outdoor sport goods industry (Benson-Rea and Shepherd, 2008; Chetty, 2004; Heath and Lassiter, 2006; Unsworth, 2010). O’Cass and Weerawardena (2009) emphasize the role of organizational innovation in SME internationalization.

The present study was designed by linking concepts from previous studies in order to create new insights that can inform decision-makers in SMEs on strategic and international issues of their firm. Our study supports previous findings that innovation, especially product innovation, impacts positively on the international expansion of a firm, and that location, especially if the firm is co-located with others in its industry, matters for the international expansion of SMEs.

It is important to consider alternative explanations for our findings, as the study is not based on a representative sample, but a theoretical sample. $H1a$ and $H1b$ are supported by the research findings, but there may be other explanations. For example, perhaps New Zealand as a location was not a particular source of CSAs for the outdoor sport goods industry, but may hold advantages for other SMEs in New Zealand with regards to international expansion. Furthermore, whether the reasons that make New Zealand a source of CSAs in the outdoor sport goods industry are applicable for other locations is arguable (e.g. Canada, which is another country with a good outdoors reputation).

$H2a$ is strongly supported and so is $H2b$. The findings indicate that product innovation, as a source of FSAs, is a significant driver in the international expansion of New Zealand-based SMEs in the outdoor sport goods industry on the path to becoming MNEs. An alternative explanation for this phenomenon could be that product
innovation within the industry or sector has been driving the businesses, rather than firm-specific product innovation. This accounts especially for more mature segments and sectors in the industry, such as, for example, sail design and manufacture within the yachting sector. This explanation refers to Porter’s (2008) fundamental theory of sources of profitability of a firm, which consists of two elements – profitability within an industry and a firm’s relative profitability in its industry. The data also indicate other factors that influenced the firm’s capability and motivation to expand internationally. Amongst those are factors such as supply chain capabilities, entrepreneurial spirit, customer orientation, and an international market focus by the firms. Further research should consider these factors to develop a more coherent picture of the antecedents for international expansion.

The study results regarding New Zealand as a source of CSAs are of practical relevance to New Zealand SMEs in the outdoor sport goods industry. It identifies ways in which a location can be beneficial to local firms in the outdoor sport goods industry. This may help SMEs to be more informed about industry- and sector-specific dynamics and characteristics to understand the business environment better. Hence, they might perform better on an international level and develop into an MNE. Furthermore, the research findings indicate that differentiation in a niche industry through product innovation is a viable strategy to achieve international growth for SMEs. The results might be valuable for SMEs from other niche industries or small countries as well. In the case of New Zealand’s economy, it can be concluded that the yachting sector has, in particular, the potential for further export growth.

A number of further managerial implications can be drawn from our case results, in combination with comparable cases from Canada (Rugman and McIlveen, 1985). Canada has similar environmental and resource endowments to New Zealand: it has a small population compared to the land mass and many natural resources, such as timber. Both economies depend extensively on export and hence, need to develop export enterprises and capabilities (Benson-Rea and Mikic, 2005; Rugman and McIlveen, 1985). Examples of successful growth of MNEs exist in both countries, such as in the pulp and paper industry in Canada, and in the dairy industry in New Zealand. These can serve as role models for promising future MNEs from our sample, or firms with similar growth potential. The key competences for the sustainable growth of MNEs in those small, open economies is the capability to, first, leverage CSAs from other countries, as advanced by the “double diamond” model (Rugman and D’Cruz, 1993; Rugman and Verbeke, 1993) and, secondly, to transform those CSAs into FSAs (Rugman and McIlveen, 1985).

The limitations of this study are threefold. One limitation lies in the sample for the empirical data collection due to idiosyncrasies of some of the firms interviewed. Such idiosyncrasies that limit the analysis and assignment of drivers for international expansion are, amongst others, specific business models and the early complete internationalization of the firm. The second limitation is the difficulty in distinguishing general business growth from international business growth. Due to the small size of most of the firms, it was sometimes difficult to get detailed data on the firm’s sales distribution in different countries and regions. The third limitation is the creation of a direct link between product innovation and international growth. Even though the interviewees provided deep insights in the firm’s operations, strategies, product innovation and internationalization activities, it was not always possible to draw a
direct line from successful product innovation and simultaneous or following international expansion of the firm. These limitations should be addressed in any future replication or extension of the study or the study’s model.

Note

1. The number of employees is the primary criterion used in OECD countries to define SMEs. The New Zealand Ministry of Economic Development defines SMEs as firms with nineteen employees or fewer. The European Union has defined SMEs as companies with fewer than 250 employees, and in North America, firms with fewer than 500 employees account for SMEs. The outdoor sport goods industry is perceived as a globalized industry, as there are many enterprises, and in particular the ones interviewed for this research, that sell their products internationally. Hence, a global approach is taken including the widest definition.

References


Further reading


Appendix. Semi-structured questionnaire

*Interview guide*

(1) Your company:

- What are your products/ product categories? How has the product range of your company changed since foundation?
- How does your business operate? Which parts of the value chain are controlled internally and which parts are controlled externally?
- What are the vision, values and competitive advantages of your company?

(2) Your industry:

- What industry are you in? How would you describe your specific niche in that industry?
- What are the current trends in your industry/niche?
- How mature is your industry in terms of an industry life cycle? Why and how do you assess that for your business?

(3) The influence of innovation on internationalization in your company:

- How often do you introduce/modify a product that is new to your company or new to the industry? Why?
- How relevant is product innovation for your industry and your company? Why?
- When and how did your company begin internationalizing?
- What were the drivers and pressures for internationalization and how did you manage those?
- Tell me about the pace and steps you took towards internationalization and in relation to changes in your products.

(4) New Zealand as a location factor for your company:

- To what extent is being a company from New Zealand important to your business? Why?
- To what extent is New Zealand as a location important to your products and product innovation?

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