CHALLENGES TO THE INTERNATIONALIZATION OF KENYAN SMALL AND MEDIUM ENTERPRISES

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DECLARATION

This Research project is my original work and has not been presented for a degree in any other University**.**

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This research project has been submitted for examination with my approval as university supervisor.

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God bless you all.

DEDICATION

To my family; Mr. Mark Lokaito from whom I get my wisdom strength and focus in life, Mrs. Eunice Lokaito from whom I get my perseverance and strong will and finally my brother Billy Ekai who remains a close friend and ally through all my tough times.

"Education is an ornament in prosperity and a refuge in adversity".

ABSTRACT

The Kenyan business environment had been undergoing drastic changes since the onset of liberalization in the early 1990’s. Some of the changes included the accelerated implementation of economic reforms, the liberalization of the economy, privatization and increased competition. With globalization and Kenya joining regional trading blocs such as EAC and COMESA coupled with the opening up of the Southern Sudan region, opportunities for these SMEs to extend their business tentacles has increased like never before but they face massive challenges in their quest to internationalization. The objective of this study was to investigate the challenges to the internationalization of Kenyan small and medium enterprises operating in Nairobi.

The study used primary data. The data collection tool was questionnaires that had both closed and open ended questions. The data was analyzed using descriptive statistics with assistance of statistical package for social sciences (SPSS). Output was then presented in terms of pie charts, graphs, frequency tables and reports.

Key findings from the study were: digital divide, educational, purchasing power difference between Kenya and the importing country, Government policies in such areas, security, language, education, and technical infrastructure, currencies and clearing system as well as banking and financial networks intellectual property e.g. copyright laws, regulatory and commerce infrastructure in the importing country and Kenya’s membership to regional trading blocs and country’s culture when dealing in international trade, level of competition in the sector, financial capital necessary to become

competitive, capital, training, and research and development accessibility, importation barriers, structure and culture of the organization are all the factors affecting internationalization of Kenyan SME.

TABLE OF CONTENTS

CHAPTER ONE: INTRODUCTION

1.1 Background of the study

As barriers to globalization continue to fade, while powerful internationalization of production and marketing continue to thrive all over the globe, African businesses should realize that competing globally is not an option, but an economic imperative. This trend is deemed to create an extra-ordinary competitive environment for developing countries, as they do not appear to be ready to face the challenges and opportunities that globalization currently present. The danger of economic and social marginalization is therefore obvious challenge to such enterprises (Rutashobya and Jaensson, 2004).

Research in the field of SME internationalization argues that the impact of globalization is not only the province of large multinational corporations, but smaller firms are also finding that the global marketplace can offer tremendous opportunity for business growth and development (Winch and Bianchi, 2006). Notwithstanding the benefits (both on a firm and macro-environment level) to be derived from international trade, Bell (1997), argues that the smaller the firm is the more vulnerable to barriers associated with resource limitations, operating difficulties and trade restrictions. Internationalization of Kenyan firms by its very nature involves a high degree of risk and SMEs tend to have more limited resources to cope with the downside of foreign expansion. As a result of this, O'Farrell and Wood (1998) observed that the barriers to entry that limit international expansion are systematically higher for smaller firms than for larger firms.

The Small and Medium enterprises have often been described as a seedbed to economic development. There is therefore a need for the Kenya government to create an environment that will stimulate small firms' competitiveness in the current globalized export markets if the Vision 2030 goals are to be attained. It is also very clear that the Kenyan enterprises cannot benefit much from the stipulated development strategies if they themselves are not proactive in their thinking and strategies. For instance, they will only benefit from deliberate market access policies under the global partnership for development if they embark on producing more value adding goods and services.

The advantages that SMEs can gain from the internationalization process are multiple, but the barriers hamper SMEs seeking to access international markets. These barriers have the effect of reducing the ability of these potential high-growth firms to achieve their full potential from international markets. As a result of this, Bennett and Smith (2002) suggest that a more efficient, nationally structured system of support for enterprise is warranted and, if support is focused, it needs to address the barriers facing SMEs firm in seeking to internationalize. SMEs are more often less able to sustain competitive threats and unfavourable macro-events in the external environment than larger firms. This is particularly characteristic of SMEs with very limited experience of international trading activity defined as "tentative" internationalizing firms (Lloyd-Reason and Mughan, 2003). For these SMEs at the early stage of internationalization, more often the internal skills and knowledge needs of the firm have been met and all is required is market intelligence to fully engage in foreign market expansion. As much as the challenges faced by these SMEs could be external, there also some internal factors that will affect internalization of the SMEs. All these internal and external factors combine to inhibit the spreading of these firms into the international market.

1.1.1 Internationalization

Internationalization is a term that has been used extensively in the literature and thus leading to different interpretation and definitions'. The term is not only confined to exporting, but also encompasses trade, cross-border clustering, cross-border collaboration, alliances/subsidiaries, branches, and joint ventures that extend beyond the home country environment. Throughout the developing countries, due to the forces of globalization, nations are embracing small- and medium-sized enterprises (SME) as a vehicle for social and economic development Solymossy and Penna (2000), and many an upsurge in international activity around the world has been evident where many SMEs are globalizing at an earlier age in comparison to previous decades (Andersson et al., 2004). As per World Trade Organization (WTO, 2007), this peak in international activities is attributed to the dynamic growth of global trade in 2006.

According to Johanson and Mattsson (1993), there are three processes of internationalisation. First, the business-strategy-based theory of internationalisation assumes that the firm has developed a source of competitive advantage in its domestic markets. If this advantage cannot be efficiently exploited within the domestic market without undue transaction costs, then the firm will seek to move outside that market and seek to exploit its sources of advantage elsewhere. Second, the process of internationalisation, also known as the Uppsala internationalisation model, describes a process of increased commitment to international sales and production. Finally, the network approach focuses on the relationships between companies. Here the company establishes and cultivates a number of relationships and networks, and the internationalisation process is dependent on the quality of the networks developed.

Mugler (1996) further suggested that many SMEs engage in opportunistic, intermittent export activity and thus a variety of strategic combinations result - with these strategies themselves becoming more and more complex (OECD, 1997). The debate surrounding small firm internationalisation has moved on from a simple for and against argument of the Uppsala model to a more holistic approach (Bell and Young, 1998). This could be perhaps in recognition of the fact that the process is affected by multiple influences within an increasingly complex trading environment. One of the key advantages for small firms within their domestic markets is their flexibility and speed of response, from changing market conditions to simple requests from customers. The traditional models of the internationalisation process as discussed above require a gradualist, incremental move though a number of different stages.

The dilemma for small firms however, is that they cannot disperse their activities and market segments as widely as their larger competitors, and so the only way is to diversify away the risk by maintaining a swift reaction capability for changing conditions. However this reduces the possibility of specialisation in achieving longer-term goals. A combination of flexibility and specialisation is ideal, but in reality is not an option for the small firm (Havnes, 1998). The internationalisation process within small firms may not be the smooth, gradualist process after all. Havnes (1998) argues that any gradualist model is meaningless without an assumed positive correlation between knowledge of internationalisation and propensity to change the activity levels in the direction of (more) internationalisation; and positive correlation between activity level and acquired knowledge.

1.1.2 Small and Medium Enterprises in Kenya

The Kenyan SME sector is a mixture of self-employment outlets and dynamic enterprises involved in an array of activities that are concentrated in urban areas but are also evident in rural Kenya. There are about 1.3 million establishments employing 2.3 million individuals and generating as much as 14% of the country's GDP (Mullei & Bokea, 1999). A majority of these small enterprises are sole proprietorships; a third of the enterprises operate from homes; and one half are female-owned. According to recent research, female-owned small enterprises are more likely to be informal, usually start smaller, use less start-up capital, grow slower if at all, have more limited access to credit and more often operate from less permanent premises and homes (Kimuyu & Omiti 2000).

Through the small enterprise sector, unskilled rural migrants acquire skills needed for survival in the more challenging urban environment. The sector also attracts skilled persons retrenched from formal sector jobs, and is often regarded as a second-best option for those unable to find or to keep jobs in the modern sector. The size of an SME's total labour force varies widely across business establishments and activities. However, the two key components of the labour force are entrepreneurs and apprentices. Informal garages absorb appreciably more apprentices and workers than the formal service sector that is dominated by proprietors. In the recent past, employment growth in Kenya's small enterprise sector has far outpaced growth in the larger modern sector (Aboagye, 1986). However, many SMEs still require workers with skills that school leavers often lack, and therefore the small enterprise sector is not likely to solve Kenya's daunting unemployment problem on its own (Ongile and McCormick, 1996).

Although most small enterprises are younger than the large ones, their ages vary across locations and activities. For the informal small businesses, the first two years are critical for survival since mortality rates are highest around this age. In many sectors, lack of entry barriers creates severe competition that leads to the demise of the less efficient and poorly managed enterprises. However, there are higher capital and skill requirements in construction and vehicle garages and this act as effective entry barriers so that there is less competition in these sub-sectors.

1.2 Statement of the Problem

The small and medium enterprises sector in Kenya is very visible and is the largest provider of essential services and goods to the general public (Central Bank of Kenya Economic review, 2009). The sector is an important component in the country and is often used as the benchmark in terms of its development and the general growth of the national economy. By being a major employer, the sector has thus contributed in constructive ways and positively to the people and economy of Kenya. As recognition of the pivotal role played by the sector, several poverty reduction strategy papers have highlighted the importance of the sector and how the government needs to strengthen its involvement both at the provision of training and formulating policies that are friendly to the sector. With globalization and Kenya joining regional trading blocks such as EAC and COMESA coupled with the opening up of the Southern Sudan region, opportunities for these SMEs to extend there business tentacles has increased like never before. Regional competitiveness from environmental pressures have also shaped SME mobilization of local resources and thus these SMEs to become more competitive and venture outside what has been traditionally their traditional sphere. However, according to the Central Bureau of statistics report (2009), the Kenyan SMEs have not taken fully advantage arising from the opportunities.

Several studies have been undertaken locally on the area of internationalization of Kenya firms. Kiilu (2005) undertook a study on the perception regarding internationalization capability in the case of Architectural Consultancy firms in Kenya. In the study, he found among others that small firms take diverse routes to internationalisation and the level of change due to internationalisation also varies considerably. He also observed that firms' require a distinctive need to focus its strategies that differentiates its experience of internationalisation from larger firms and the predictions of stages theory. On his part, Bidu (2009) carried out a research on the Influence of political risk factors on the internationalisation decisions of Horticultural exporting firms in Nairobi. The findings of the research were that with globalization, instability in any country will influence the level of exports made in the country. It was also found out that for effective internationalisation process to take place, and then there should be a concerted effort by the political establishment to lobby for its firms to trade in other countries under favorable terms. Mulwa (2009) carried out a research on the internalization process of Equity Bank and she found out that for an effective internalization the managers of a firm should be knowledgeable on foreign markets. The amount of knowledge the decision maker has about internationalisation is influenced by the decision-makers' level of education. As can be evidenced from the above studies, there has been no study on the challenges' that hinder the internationalisation of SMEs in Kenya. This therefore leads to the following research question: What are the challenges to the internationalisation of SMEs in Kenya?

1.3 Research Objectives

The overall objective of this study is to:

(i) Establish the challenges that Kenyan SMEs face in their internationalisation process.

(ii) Determine how the Kenyan SME firms counter the challenges from the internationalisation process.

1.4 Importance of the study

Studies have been carried out on the internationalisation of various Kenya firms. However a study on the challenges faced by the SMEs in Kenya while internationalizing has not been undertaken. Thus the study will be of importance to policy makers and implementers within the sectors in understanding the challenges that the sector faces and therefore help in coming out with mechanisms of countering the challenges. The study will give information on areas that need to be refined and redefined in order to ensure that the sector achieves its goals of internationalizing. The study will also provide useful information on which components are all-important and must be taken into consideration in developing regional trading policies.

To the individual Kenya SMEs, the study will be an invaluable source to the management on how to remedy the challenges encountered by the firms in their quest of internationalisation. The study will also delve into challenges that arise from the individual SMEs internal operations that will inhibit the internationalisation process. From this, the firms will put in place strategies to counter the challenges and hence foster their business spheres. It will provide information to the sector that will result in sound and more informed decisions when formulating strategies and to understand the underlying factors that are pertinent in the process. These factors will give direction on the structure of the process and weighting across the components required in implementing and formulating the plan.

To Scholars: This study is expected to increase body of knowledge to the scholars in the service industry and make them in be touch with the challenges that local SMEs face in their internationalisation process and hence be in a position to formulate ways of remedying the same to foster growth in the sector.

CHAPTER TWO: LITERATURE REVIEW

2.1 The Internationalisation Process

The academic literature continues to wrestle with appropriate definition of the term internationalisation process. In the various studies, the term “internationalisation” comes out as ambiguous, and definitions vary in the scope of phenomena they include. Welch and Luostarinen (1988, p. 36) define internationalisation as “the process of increasing involvement in international operations” whereas Calof and Beamish (1995, p. 116) define internationalisation as “the process of adapting firms’ operations (strategy, structure, resources, etc.) to international environments”. On his part Calof and Beamish's (1995) expounded its definition to include the phenomenon of de-internationalisation, which happens when a firm has to reduce its international sales or withdraw from the international market. Firms can de-internationalise by dropping a product (Calof and Beamish, 1995), by withdrawing from foreign direct investment and returning to exporting (Chetty, 1999), by reducing international activities or by withdrawing altogether from international operations (Benito and Welch, 1997).

According to Johanson and Mattsson (1993), three processes of internationalisation comes out as a more conclusive definition. First, the business-strategy-based theory of internationalisation assumes that the firm has developed a source of competitive advantage in its domestic markets. If this advantage cannot be efficiently exploited within the domestic market without undue transaction costs, then the firm will seek to move outside that market and seek to exploit its sources of advantage elsewhere. Second, the process of internationalisation, also known as the Uppsala internationalisation model, describes a process of increased commitment to international sales and production.

Finally, the network approach focuses on the relationships between companies. Here the company establishes and cultivates a number of relationships and networks, and the internationalisation process is dependent on the quality of the networks developed (Johanson and Mattsson (1993).

A number of different theorisations of processes of growth in a firm's international operations have been advanced by various scholars (Cavusgil and Nevin, 1981; Johanson and Vahlne, 1977). These studies have considered internationalisation to be a gradual, sequential process through different stages, with the firm increasing its commitment to international operations as it proceeded through each stage. This pattern-oriented approach, because it uses stages as its central concept, is often referred to as the stages model. Various stages models of internationalisation have been proposed: first, the Uppsala process model (Johanson and Vahlne, 1990), second, the innovation-adoption internationalisation models (Andersen, 1993) and third, the management decision making process towards internationalisation (Reid, 1981).

The most frequently used of these stages models is the Uppsala process model. It emphasises learning by focusing on market knowledge and commitment. To minimise risk and overcome uncertainty, it says that firms internationalise in a step-by-step process. As firms gain market knowledge they commit more resources to the market. Increased commitment occurs in the following stages:

The incremental, gradualist internationalisation model has been increasingly challenged in recent years, as a number of studies (Voerman *et al.*, 1999; Mugler, 1996) have suggested that many SMEs engage in opportunistic, intermittent export activity. Increasingly SMEs use a variety of strategic combinations, with these strategies themselves becoming more and more complex. The debate surrounding small firm internationalisation has moved on from a simple for and against argument of the Uppsala model to adopt a more holistic approach (Bell and Young, 1998) in recognition of the fact that the process is affected by multiple influences within an increasingly complex trading environment. One of the key advantages for small firms within their domestic markets is their flexibility and speed of response, from changing market conditions to simple requests from customers.

The dilemma for small firms however, is that they cannot disperse their activities and market segments as widely as their larger competitors, and so the only way is to diversify away the risk by maintaining a swift reaction capability for changing conditions. However this reduces the possibility of specialisation in achieving longer-term goals (Reason and Mugham, 2003). A combination of flexibility and specialisation is ideal, but in reality is not an option for the small firm. The internationalisation process within small firms may not be the smooth, gradualist process after all. Havnes (1998) argues that any gradualist model is meaningless without an assumed positive correlation between knowledge of internationalisation and propensity to change the activity levels in the direction of (more) internationalisation; and positive correlation between activity level and acquired knowledge. That is, although a number of small firms do indeed exhibit incremental and stable change patterns, this is certainly not true of all small firms, where intermittent and irregular change is a frequent characteristic of small firm behaviour with regard to their international activities (Havnes, 1998).

2.1.1 Sources of internationalisation knowledge and expertise

The internationalisation studies have identified a considerable range of mechanisms through which firms accumulate the knowledge and expertise they need. Several studies show that a firm can acquire knowledge from its customers, which can be used for further market entry and expansion (Hertz, 1993**;** Lee, 1991)**.** According to Madhok (1997), the development and integration of new knowledge happens incrementally. Supplier-customer interaction enables the two firms to develop knowledge about each other's needs and capabilities and to create new knowledge. These partners also accumulate knowledge about other actors in their counterpart's domestic market, thus embedding them in each other's business environment. When a supplier uses an existing customer relationship to develop new ones in the foreign market, the customer is known as a bridgehead (Johanson and Mattsson, 1988). The relationship a supplier has with a customer in a foreign market enables it to expand within that customer's country. A bridgehead customer allows the supplier to acquire knowledge and to create new knowledge incrementally.

As firms internationalise they are learning about their markets and this frequently occurs through their business networks. A firm's learning is seen by Cohen and Levinthal (1990) as the ability of a firm to use its prior related knowledge and diverse background to identify the value of new information and to develop this into something creative. They use the term "absorptive capacity" when they refer to a firm's ability to "recognise the value of new, external information, assimilate it, and apply it to commercial ends" (Cohen and Levinthal, 1990, p. 128). A firm may decide not to exploit new information even though this information could be important due to the reason that the capacity to absorb knowledge is dependent on its existing knowledge and if the firm has no prior experiences with foreign customers it finds it hard to attain this knowledge base (Cohen and Levinthal, 1989).

The primary concern for an international firm is how the previously developed knowledge can be applied in a specific new market. A firm, which operates in diverse markets, can acquire a rich amount of knowledge and strong technological capabilities through exposure to a variety of ideas and experiences (Barkema and Vermeulen, 1998). These new ideas and new practices encourage innovations and thus enhance the firm's capabilities (Miller, 1996). When a firm enters a new market it is confronted with new customers' needs and new testing grounds for its technology, which means that it has to find new solutions and develop stronger technological skills (Argyres, 1996). In addition, failures may be experienced by firms operating in unfamiliar markets where customers, suppliers, competitors are different (Simon, 1955). Failures encourage the firm to seek new solutions that enhance its capabilities thus enabling it to obtain knowledge, which is costly for its competitors to acquire (Madhok, 1997).

As an organisation builds a dynamic network of relationships both from within and outside, individuals will recognise the capabilities and knowledge of others (Cohen and Levinthal, 1990). Consequently, individual capabilities are leveraged, thus increasing an organisation's capability. When a firm has developed the capabilities to accumulate knowledge in one relationship then it becomes more effective in accumulating additional knowledge in other relationships (Cohen and Levinthal, 1990). In their study Barkema *et a*l (1996) showed that when a firm expands within a country it gains more from previous experience with customers in the same country. They argue that the significance of previous experience in the same country supports the view that "experiential" knowledge (Johanson and Vahlne, 1977) from a country is important, and that it increases the success rate of expansion within the same country.

2.1.2 Internationalisation of SMEs

In SMEs the decision maker characteristics such as knowledge, attitudes and motivation play a key role in the internationalisation decision of the firm (Bloodgood *et al*, 1996; Chetty, 1999). Cavusgil and Nevin (1981) found two internal determinants that were important for propelling firms into internationalisation. These were first, management's expectation of a significant impact on the growth of the firm through internationalisation and second, a high degree of commitment to internationalisation. On their part, Calof and Beamish (1995) found that it was the attitudes of decision makers in SMEs that propelled them into internationalisation rather than environmental factors. In order to attain international success a firm has to not only have the appropriate product and strategy but its decision makers must have the appropriate attitudes as well (Calof, 1994). It is these attitudes that determine how decision makers perceive the benefits, costs and risks of internationalisation (Calof and Beamish 1995). The attitudes that determine international decisions are shaped by the decision-makers' past experiences as well (Holbrook *et al* 2000).

The intention to internationalise is influenced by managerial beliefs about the firm's competitive advantage, readiness to export, the risk associated with internationalisation and the perceived internal and external barriers towards internationalisation (Jaffe and Pasternak, 1994). The founders of these firms shape these beliefs, which persist even after they have left. Sometimes this belief system can be a competitive advantage for the firm or it can be a deterrent as reported by Madhok (1997) who found out that the firm's belief systems consisted of past routines that can create obstacles when new routines are required.

One of the greatest barriers to the initial internationalisation decision is the lack of knowledge about foreign markets (Johanson and Vahlne, 1978). The amount of knowledge the decision maker has about internationalisation is influenced by the decision-makers' level of education, foreign market experience, ability to speak a foreign language, and whether they were born abroad (Simmonds and Smith, 1968). Managers in already internationalized SMEs, however, are actively involved in the firm's international activity, which means they have access to this new knowledge. This gives them the chance to "learn by doing" and to integrate this knowledge as a firm competence (Zahra *et al* 2000).

However not all the SMEs pursue growth as their key objective. Some want to maintain control of the firm while others perceive that they have limited resources such as financial and information, and management time and experience to grow. One of the limitations of growth through internationalisation is a lack of resources (Welch and Luostarinen, 1988). Firms do overcome this limitation by forming business networks to acquire these resources and to benefit from being larger in size as a result of their networks. For example, firms that have limited foreign market knowledge and experience seek this knowledge from their distributors and customers (Welch and Luostarinen, 1988). By forming these networks SMEs expedite their internationalisation efforts and improve their success rates. In fact, several studies propose that to enhance understanding of the internationalisation of SMEs researchers should study how these firms use their business networks to internationalise (Chetty and Blankenburg Holm, 2000).

2.2 Organizational change from internationalisation

Internationalisation is generally understood as an evolutionary process during which a company adapts to the international environment (Calof and Beamish, 1995). The aspect of progressive change in this process is emphasised by several researchers. The importance of the strategic perspective has also been underlined: expansion to international markets requires changes in the company strategy in order for it to fit into the new environment Strategic fit is particularly important for rapidly internationalising companies, which need internationally fit strategies, policies and procedures from inception (Schuh, 2001). Nummela(2004) focused on changes that were due to internationalisation and concluded that the company level changes related to internationalisation is reflected both internally and externally in the organisation.

External changes are those that can be seen from the outside, such as changes in export strategy (products, markets, operations), whereas internal changes are related to the organisational structure, finance and personnel (Welch and Luostarinen, 1988). In the course of time, a small firm has to decide whether to adapt the strategy and its key elements: which products/services it will offer, how and to which markets. These decisions are naturally affected by environmental factors, and they may vary according to the market. A small firm may have to reassess the company's financial arrangements, reconsider its organisational structure or diversify its personnel in order to acquire the skills and resources needed for internationalisation.

The limited interest in the financing of small-business internationalisation is surprising (LeCornu *et al.*, 1996). It is generally assumed that the financial management of small firms is different from that in large firms and therefore, it could also be assumed that this difference is more pronounced in the context of internationalisation where the contradiction between growth and limited resources is stressed. Internationalisation impacts the performance of the firm, and changes can be measured in terms of turnover and/or profit development, as well as by the export ratio. However, it may take considerable time before exports create positive cash flows, and internationalisation usually requires substantial upfront financial investments. Growth can be financed by reallocating cash flow from other activities, but also otherwise, e.g. by debt or equity arrangements. In general, small firms find the funding of internationalisation problematic. Either the choice of alternatives is restricted or the manager's preferences for the available alternatives may be biased. It could be argued that, because some small firms do not fully meet the qualifications, the funding available is partly deficient and thus there will always be a gap between supply and demand (Hamilton and Fox, 1998).

Internal changes are tightly intertwined, and finance changes may have effects on the organisational structure (e.g. minority ownership) and vice versa. Arguably, as a company internationalises, administrative and organisational demands increase and the company responds to this by making organisational rearrangements (Welch and Luostarinen, 1988). An increasing number of partnerships and alliances have been considered one of the distinctive characteristics of globalisation, providing ways for companies to match their capabilities to the changing environment (Sachwald, 1998). The shortened time span in business operations requires even more effective and concise utilisation of the network, particularly for foreign markets entry. This, in turn, leads to variety in governance structures. According to Parker (1996) because of globalisation, organisations use more hybrid forms instead of traditional governance structures. Miles and Snow (1986) argued that the rising new organisational forms were both causes and effects of the changing nature of the new environment. According to them, strategies and structures are based on managers' attempts to match companies' capabilities to the environment.

2.3 Challenges of Internationalization

According to Sikka (2005), the strategic challenges facing Indian SMEs can be classified into three broad categories: country specific, industry specific and firm specific issues. He observed that for a firm to venture successfully in the international trade, and then it will need to address the three critical challenges.

2.3.1 Country specific challenges

Country specific challenges are generally those that are uncontrollable, external factors that impact the firm such as the economic, legal and regulatory, and social-cultural forces. Challenges unique to promoting the growth of information technology include governmental support of the required telecommunication and electronic infrastructure. Growth in technological capabilities and usage is resulting in greater global interconnectivity and can be used as a media for expansion of SMEs (Tseng et al., 2004). As was observed by Panagariya (2000), access to e-commerce is characterized by the World Trade Organization (WTO) as consisting of two critical components: access to internet services; and access to services that can be traded electronically. The access of e-commerce deals with the user infrastructure, while the latter pertains to specific commitments in electronically traded services.

Gupta (2004) noted that an issue that has been a topic of interest concerning communication technology and emerging markets has been the presence of the digital divide. The digital divide is defined in terms of the diffusion of information and communications technologies and the difference between industrial countries and developing countries (or, in some cases, between the rich and the poor, urban and rural within countries). A digital divide between developed and developing nations is expected due to great differences between many areas besides computer readiness, these include health, education, purchasing power, and other economic indicators (Rastogi, 2005b).

The regulatory and commerce infrastructures, consisting of legal services, currencies and clearing systems, as well as the banking and financial networks, play a significant role in the adoption of information technology and the reduction of many structural impediments (Javalgi and Ramsey, 2001). Once the country decides to support participation in e-commerce, regulatory procedures, and legal frameworks have to be changed. Modifications are dictated by geography and the crossing of international boundaries, as business transactions may not be bound by the same legal codes. In addition, intellectual property, particularly software copyright, piracy rates, copyright laws, issuing of domain names, and cyber squatting are some of the issues that are largely unresolved. A primary problem is that laws are generally limited to geographical jurisdictions (Frye, 2001, McKenna, 2001).

Many businesses and consumers continue to be concerned about conducting business on the internet because of the lack of privacy, security, and liability. E-commerce users are also concerned about the possibility that their governments will impose extensive regulations on the internet in such areas as tax and duties, content restrictions, and non-cooperation to induce trade barriers for certain goods and services that are vital to build information infrastructure. The future and international growth of e-commerce depends upon the extent to which the country's government protects, supports, and educates its citizens. Governmental policies in such areas as support for R&D, privacy, security, and needed education to compete in the information age, greatly influence the growth of e-services (Sikka, 2005).

2.3.2 Industry specific challenges

Industry specific factors focus on the areas of business that are attributable to the business environment in which the firm operates. As was noted by Shridhar (2006), many of the industry specific factors are significantly impacted by the government. He further observed that after many countries attained independence, the new governments adopted new philosophies resulting in an economic and political philosophy focused on fostering self-reliance and import substitution (Shridhar, 2006).

The resulting import barriers created a business environment where SMEs experienced very little competition from firms outside of the country, because the domestic market was large and there were virtually no outside competitors. SMEs grew and flourished (Shridhar, 2006). However with globalizations and liberalization of the national economies, many SMEs were no longer protected and began to feel pressure from outside competition. The increase in competitive intensity due to reduction in trade barriers is a driving force for many developing countries SMEs as they need to improve efficiencies and innovativeness.

2.3.3 Firm specific challenges

Firm specific factors include capital, training, and research and development accessibility. SMEs, due to their size limitations, often have limited financial capital and a lack of necessary human resources (Buckley, 1989). SMEs in most developing countries face problems in obtaining the financial capital necessary to become competitive and achieve economic growth (Gupta et al., 2005). Obtaining loans is a challenge because bankers perceive lending to SMEs to be risky due to poor repayment records and low market credibility (Gupta et al., 2005).

Firm specific factors also include the structure and culture of the organization. This is evident in terms of entrepreneurial orientation and global mindset. Organizational sociologists report that the organization’s performance is dependent on the sociological views of its employees and management (Arora et al., 2004). Ireland et al. (2003) describe an entrepreneurial mindset as a perspective that is focused on growth through the application of flexibility, creativity, continuous innovation, and renewal. According to Gupta and Govindarajan (2002), a global mindset is one in which organizations and their employees observe and make sense of their surroundings by processing information through their own unique cognitive filters. With regard to SMEs the corporate culture is particularly important because the perception of key managers, either owner or general manager, have a stronger influence on strategy when dealing with uncertainty in the business environment (Weaver et al., 2002).

2.4 Overcoming challenges of internationalization

According to Porter's (1990) Competitive Advantage of Nations, there are four major factors that contribute to the success of a country in terms of utilization of resources to create a competitive advantage. They are demand conditions, factor conditions, presence or absence of supporting suppliers, and the degree of rivalry in the domestic market. Also considered is the firm's structure, strategy and the degree of governmental influence.

However, Sikki (2005) notes that, if the following infrastructures, related to education and workforce quality are not enhanced then the rest of the factors cannot not be fully developed. Factor conditions deal with the factors of operation. The IT sector in countries such as India can utilize the relatively low cost, educated work force, generally proficient in the English language (Kapur, 2002). The necessary infrastructure can be developed in the meantime. Government support in research and development and its investment in higher education, especially in the engineering discipline, further build the availability of skilled human capital (Kapur, 2002). Access to a quality workforce, in the IT sector, has been shown to be one of the most important factors leading to competitive advantage (O'Malley and O'Gorman, 2001).

Entrepreneurial organizations are characterized by their adoption of innovative ideas and processes (Covin and Slevin, 1991). The availability of technological tools enables entrepreneurs to establish a competitive advantage through their early embrace of the innovations being made in the field of information systems. If the infrastructure can be developed to allow access to computer services, entrepreneurial firms should be the first to successfully utilize the technology. The overall economic health of a nation/region has a significant effect on and is impacted by the usage of e-commerce and its growth. For example, when the economy grows the demand for new products and services also grows. Therefore, it is obvious that the health of an economy affects trade and investment flow. E-commerce is fundamentally affecting the way business is conducted across many service industries around the world. The focus is on speed, connectivity, efficiency, and sharing and exchanging of goods, services, and information in the new economy (Javalgi and Ramsey, 2001).

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Research design

The research design for the study will be a survey. The survey research design is deemed appropriate in this study because of the large number of organizations involved and the need for comparative analysis. This technique will allow the researcher to draw conclusions about the relationship existing in the population and also characterize their phenomena. This method will also facilitate the drawing of inferences and help in maintaining the continuity of the research process.

3.2 Population of the Study

The population of the study will consist of SMEs operating in the industrial area and at the same time engaged in the exporting of their products. According to the Nairobi City council (2009) licensing data, there are over 1000 SMEs operating in Industrial area. The selection of SMEs based in Nairobi Industrial area was necessitated by the fact that, it is the single location in the country with such large number of enterprises concentrated in one single area. In addition by the fact that some of these firms are engaged in exportation business, they will be exposed in internationalization challenges and hence will be in a better position to aid the research in the attainment of its objectives. Further, with such a number of enterprises in one locality, competition is stiff within them and thus will most likely institute strategies of how to mitigate against the challenges arising.

3.3 Sample design

A convenience sample of 100 SMEs engaged in the international trade will randomly be selected. According to Mugenda and Mugenda (2003) a sample of 10% is considered representative. Respondents will be selected randomly based on their location in the industrial area so as to cover most parts of the area as much as possible. This approach will be considered appropriate since the use of random sampling survey ensures a representative sample of enterprises. In addition, considering the time and budget constraints it is considered an appropriate sampling strategy that will yield representative results.

3.4 Data Collection

The study will use primary data; these will be collected through self-administered questionnaires. Structured questionnaire will be used that consist of both open and closed ended questions designed to elicit specific responses for qualitative and quantitative analysis respectively. Respondents will be the managerial level employees at the respective firms who are privy to the challenges the firms face in their internationalization trade. The respondents will be expected to give an insight into the nature of challenges the firms face in internationalization business in the respective firms.

3.5 Data Analysis and Presentation

The data will be analyzed by the use of descriptive statistics to summarize and relate variables, which will be attained from the administered questionnaires. The data will be classified, tabulated and summarized using means, standard deviation, and frequency distribution. Tables and graphs will be used for presentation of the findings. However, before final analysis is performed, data will be cleaned to eliminate discrepancies and thereafter, classified on the basis of similarity and then tabulated. Cross tabulation will be used to compare the existence of relationship between the individual firm size and the nature of challenges faced in its internationalization trade. In accomplishing all analysis details with efficiency and effectiveness, the researcher will utilize the Statistical Package for Social Sciences (SPSS) software.

CHAPTER FOUR: DATA ANALYSIS, FINDINGS AND DISCUSSIONS

4.1 Introduction

The research objective was to establish the challenges to the internationalization of Kenyan Small and Medium Enterprises. This chapter presents the analysis and findings with regard to the objective and discussion of the same. The findings are presented in percentages and frequency distributions, mean and standard deviations.

4.2 Characteristics of the respondent firms

A total of 100 questionnaires were issued out. The completed questionnaires were edited for completeness and consistency. Of the 100 questionnaires used in the sample, only 74 were returned. The remaining 26 were not returned. The returned questionnaires' represented a response rate of 74%.

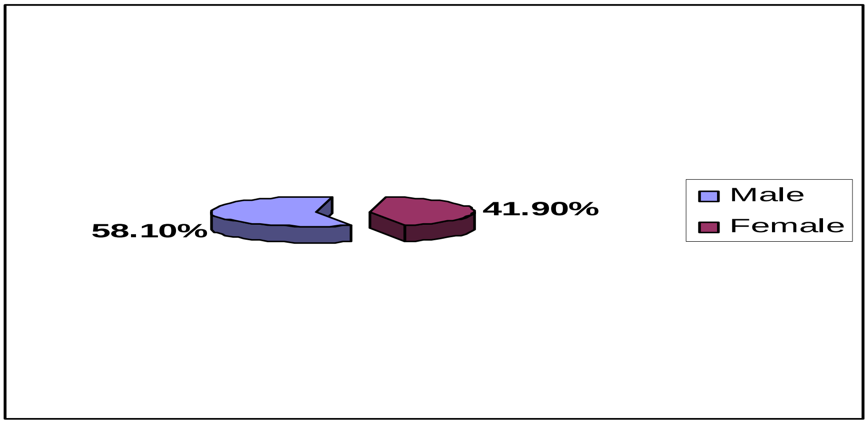
4.3 Demographic and respondents profile information

The demographic information considered in this study for the respondents included the gender of the respondents, age, length of service with SME and SME existence duration.

4.3.1 Gender

Of the 74 respondents, 58.1 percent were female while 41.9% were male.

Figure 4.1: Respondents gender



4.3.2 Age Bracket

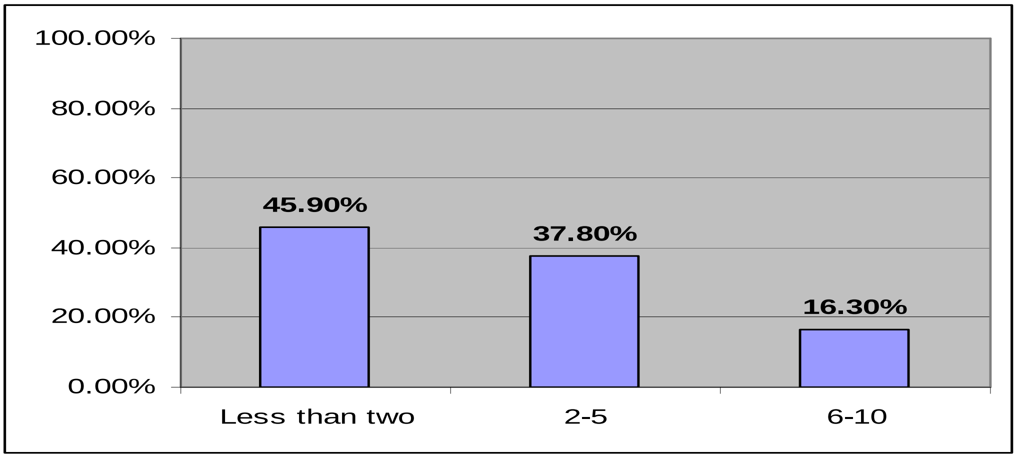
Table 4.1: Age bracket of the respondents

	Frequency	Percent	Cumulative Percent
21-30	31	41.9	41.9
31-40	24	32.4	74.3
41-50	11	14.9	89.2
Over 50	8	10.8	100.0
Total	74	100.0	

The findings presented in table 4.1 show that, 41.9 % of the respondents were of 21-30 years, 32.4% were between 31-40 years of age, 14.9% were between 41-50 years old and a few (10.8%) were over 50 years. On average the majority of the employees are between the age brackets of 21-30 years.

4.3.3: Length of Service with organization (Years)

Figure 4.2: Length of Service with organization (Years)



The results presented in table 4.2 shows that the number of years of service in the current organization varies from a period of less than 2 years to 10 years. 45.9% of the respondents had worked in their respective organizations for less than 2 years, 37.8% had worked for a period of 2 to 5 years while 16.3% had worked for a period of 2 to 5 years. Majority of the respondents have worked in their organization less than 2 years, thus there is low level of understanding of their organization.

4.3.4 Duration of SME existence (Years)

Table 4.2: Duration of SME existence (Years)

	Frequency	Percent	Cumulative Percent
Under 5	19	26.2	26.2
6-10	47	63.0	89.2
11-15	2	2.7	91.9
Over 25	6	8.1	100.0
Total	74	100.0	

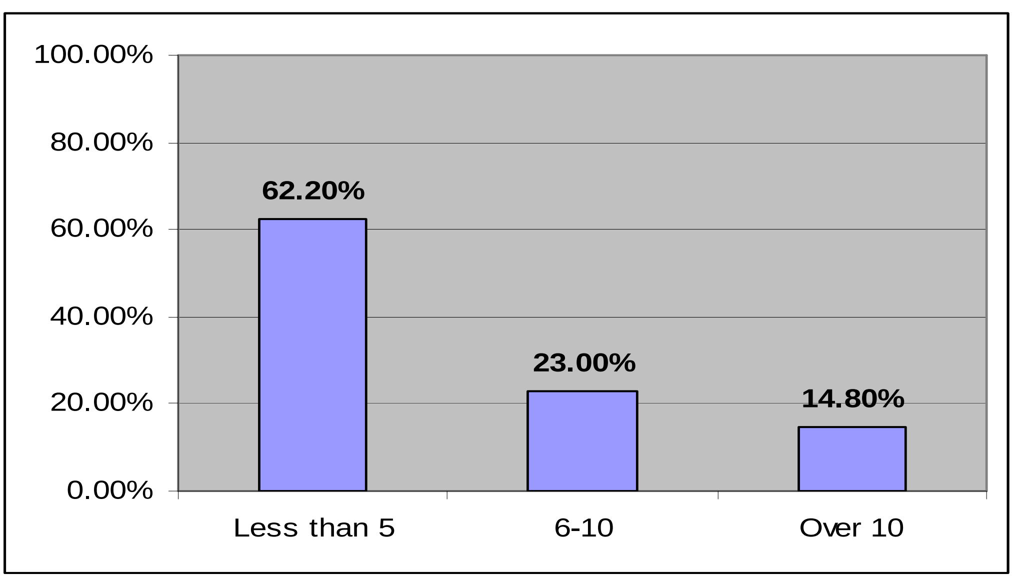
From the findings 63% of the respondents said the SMEs they worked for have been in existence for a period of 6 to 10 years, 26.2% said they have been in existence for less than 5 years while 8.1% of the respondents said theirs have been in existence for over 25 years. 2.7% of the respondents said the SMEs have been in existence for 11 to 15 years. Majority of the SMEs have been in existence for a period of 6 years and therefore they have understood the market that they serve well.

4.4 International Business

Internationalization encompasses trade, cross-border clustering, cross-border collaboration, alliances/subsidiaries, branches, and joint ventures that extend beyond the home country environment.

4.4.1 Number of countries transacting with the SME

Figure 4.3: Number of countries transacting with the SME



The findings indicates that majority of the respondents (62.2%) said their SMEs transact with less than 5 countries, 23.0% of the SMEs transact with 6 to 10 countries while 14.8% of the respondents said they transact with over 10 countries. The findings show that the SMEs have diversified their customers and therefore they are in a position to know where the good market is and the challenges they face in penetrating the markets.

4.4.2 Country specific factors

The respondents were to give their independent opinion on the effects of the factors below in international trade in a five point Likert scale. The range was ‘Strongly agree (1)’ to ‘strongly disagree’ (5). The scores of strongly agree/agree have been taken to present a variable which had mean score of 0 to 2.5 on the continuous Likert scale ;(0≤ S.E <2.4). The scores of ‘moderate extent have been taken to represent a variable with a mean score of 2.5 to 3.4 pm on the continuous Likert scale: 2.5≤M.E. <3.4) and the score of both disagree/strongly disagree have been taken to represent a variable which had a mean score of 3.5 to 5.0 on a continuous Likert scale; 3.5≤ L.E. <5.0). A standard deviation of >1.1 implies a significant difference on the impact of the variable among respondents.

Table 4.3: Country specific factors

	Mean	Std. Deviation
Kenya's membership to regional trading blocks	2.5811	1.04694
The digital divide, educational, purchasing power difference between Kenya and the importing country	1.8514	1.08138
Regulatory and commerce infrastructure in the importing country	2.5000	1.27408
Currencies and clearing system as well as banking and financial networks	2.2162	1.19669
Intellectual property e.g. Copyright laws	2.4865	1.07580
Government policies in such areas as R&D, security	1.8243	.81691
A country's culture	2.4865	1.07580
Language, education, and technical infrastructure	2.0135	.95793

The respondents agreed that their organization is affected by factors like digital divide, educational, purchasing power difference between Kenya and the importing country, Government policies in such areas as R&D, security, language, education, and technical infrastructure, currencies and clearing system as well as banking and financial networks and country's culture when dealing in international trade. However intellectual property e.g. Copyright laws, regulatory and commerce infrastructure in the importing country and Kenya's membership to regional trading blocks do affect SMEs to a moderate extent when dealing with international trade. It is apparent that all the factors affect SMEs performance when dealing with international trade and therefore for them to succeed they need to counter the factors if they have to succeed.

4.4.3 Industry specific factors

Table 4.4: Industry specific factors

	Mean	Std. Deviation
Importation barriers	2.1486	1.0557
Lack of innovativeness and efficiency in the firm	2.6351	1.0280
Level of competition in the sector	1.6757	.7783
Capital, training, and research and development accessibility	1.8919	.7687
Financial capital necessary to become competitive	1.7297	.8159
Structure and culture of the organization	2.1486	.8550

The findings in table 4.4 above show that only one factor had a mean ranking of below 3 (moderate extent). This factor describes instances where the level of influence is low and its low ratings (mean 2.9 for lack of innovativeness and efficiency in the firm) indicate the factors do not affect SMEs when dealing in international trade. The respondents agreed that their international trade is affected by the level of competition in the sector, financial capital necessary to become competitive, capital, training, and research and development accessibility, structure and culture of the organization and importation barriers. However there was a high degree of variation among respondents, an indication that some factors do not affect international trade of the SMEs. This is indicated by standard deviation of 1.0557 and 0.8550 for importation barriers and structure and culture of the organization respectively.

4.4.4 Importance of factors in response to competition

Table 4.5: Importance of factors in response to competition

	Mean	Std. deviation
Market focusing	1.6237	0.3127
Market segmentation	1.3456	0.2942

The findings indicate that the respondents focus on particular segments of the market. The SMEs practice market segmentation through establishing niches. The standard deviations do not vary significantly from the means, thus supporting the findings.

4.4.5 Cost leadership

Table 4.6: Cost leadership

	Mean	Standard Deviation
Use of latest technology	1.625	0.992
Cost cutting	1.250	0:433
Business process rationalization	1.500	0.261
Staff reduction	2.00	1.166
Automation of operations	1.875	1.452

The findings above show that all the SMEs place greater emphasis on the cost leadership factors. Majority of the SMEs (mean 1.25) views cost cutting measures as a way of gaining competitive advantage over its competitors followed by business process rationalization (mean 1.5) then the use of latest technology with a mean of 1.625. Automation of operations and staff reduction with a mean of 1.875 and 2.0 respectively was not used mostly by the SMEs. Generally an organization can gain competitive advantage over its competitors by adopting one of the strategies above.

4.4.6 Differentiation

Table 4.7: Differentiation

	Mean	**Std. Deviation**
Customer service	1.1522	0.0742
Increased advertisement	1.8696	0.9799
New products/services	1.5435	0.3478
Branding	1.3478	0.7368
Staff training	1.6391	0.7050
More strategic locations	1.5435	0.2239

The respondents unanimously agreed that all the factors identified were necessary for an organization to differentiate itself from its competitors (mean of 2.0 and below). Customer service (mean 1.1522) was the factor which majority of the SMEs puts more emphasize on followed by branding (mean 1.3478). Increased advertisement (mean 1.8696) was rated as a factor which is not mostly used by the outlets in order to differentiate themselves.

CHAPTER FIVE: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary

The study established that majority of the SMEs have been in existence for a period of more than 5 years and therefore they have understood the customers' expectation and the markets that they serve. The number of countries in which the SMEs operated varied but majority of them serve less than 5 countries indicating that they are still young SMEs and expanding. It was apparent that the SMEs are affected by specific factors which affect the country and these factors include digital divide, educational, purchasing power difference between Kenya and the importing country, Government policies in such areas, security, language, education, and technical infrastructure, currencies and clearing system as well as banking and financial networks intellectual property e.g. copyright laws, regulatory and commerce infrastructure in the importing country and Kenya's membership to regional trading blocs and country's culture when dealing in international trade.

The respondents agreed that the level of competition in the sector, financial capital necessary to become competitive, capital, training, and research and development accessibility, importation barriers, structure and culture of the organization are all the factors affecting the industry in which the SMEs are. It was noted that focus strategic option to internationalization factors led to increased market focusing by the SMEs and market segmentation of the markets. These will assist the SMEs to focus on the segmented market thus satisfying its customers. The respondents indicated that they use cost leadership factors to reduce the amount of costs that they incur both locally and internationally. The respondents agreed that they differentiate themselves from their competitors by the use good customer service, increased advertisement, new products/services, branding, more strategic locations and staff training.

5.2 Conclusion

From the research findings and the answers to the research questions, some conclusions can be, made about the study.

From the research findings the foremost conclusion that can be made about the study is that the number of countries in which the SMEs transact has a direct relationship with the duration majority of the SMEs have been in operation. Since majority of the SMEs have been in operation for over 6 years and they have managed to have markets in less than five countries, this is an indication that they are aggressive in their marketing.

Secondly the SMEs face numerous challenges when dealing with international business. These factors involve those relating to the country in which the SMEs are dealing with internationally and that affect the industry in which the SMEs operate. The SMEs can do little regarding the challenges resulting from the imposition of some restrictions by a country but they can as well lobby their government to negotiate for relaxation of the factors. The industry factors on the other hand results from factors affecting the industry in which the SMEs operate and these includes level of competition in the sector, financial capital necessary to become competitive, capital, training, and research and development accessibility, importation barriers, structure and culture of the organization. With regard to the three strategic options available to firms, the SMEs put emphasis on all the options in order to beat competition from its competitors and by combining all the factors they will be able to achieve their targets at the end of the year.

5.3 Recommendations

This study makes a few recommendations that have policy implications for decision makers. The study found out that the SMEs faces numerous challenges when dealing with international trade and these challenges results from the government and the industry in which the SMEs operate. It is therefore recommended that the government should protect the local SMEs by sourcing for them markets for the goods and also negotiating with the other countries when the SMEs encounter challenges as a result of the government.

The SMEs on their part should play a leading role by ensuring that the challenges which results from their part especially the ones which they can solve by being innovative, changing the structure of the organization and financial should be dealt with expeditiously. The use of all the strategic options by the SMEs will ensure that if one option fails then they can use the other to respond to the changes in the market. It is recommended therefore that if the SMEs can use all the strategic options then they can use if they have sufficient resources.

5.4. Recommendations for further research

The study confined itself to SMEs operating in industrial area and dealing with internationalization. This research therefore should be replicated in other SMEs operating in the whole country and the results be compared so as to establish whether there is consistency among the SMEs.

5.5 Limitations of the study

This study was based on a sample limited to SMEs operating in Nairobi. It did not cover other SMEs operating in the country and therefore the findings of the study may not be a representative of the challenges facing all the SMEs dealing in internationalization.

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APPENDIX II: QUESTIONNAIRE

Please give answers in the spaces provided and tick (√) in the box that matches your response to the questions where applicable.

PART A: DEMOGRAPHIC AND RESPONDENTS PROFILE

1) Name of SME: …………………………………………………………………

2. What is your designation at the organization………………………………………..

3. Gender: male ( ) Female ( )

4. What is your age bracket? (Tick as applicable)

a) Under 20 years	( )	c) 31 – 40 years	( )
b) 21 – 30 years	( )	d) 41 – 50 years	( )
e) Over 50 years	( )		

5. Length of continuous service with the organization?

a) Less than two years	( )	c) 6-10 years	( )
b) 2-5 years	( )	d) Over 10 years	( )

6. For how long has your organisation been in existence?

a) Under 5 years	( )	d) 16 – 20 years	( )
b) 6 – 10 years	( )	e) 21 - 25 years	( )
c) 11 – 15 years	( )	f) Over 25 years	( )

PART B: INTERNATIONAL BUSINESS

7. How many countries does your firm transact with?

a) Less than 5 Countries ( )

b) 6 – 10 countries ( )

c) Over 10 countries ( )

8.) Please tick the number that best describes the extent to which your organization is affected by the following factors in your international trade: (Use the scale below to tick the most appropriate response)

1) Strongly Agree 4) Disagree

2) Agree 5) Strongly Disagree

3) Moderate extent

	Country specific factors	1	2	3	4	5
1	Kenya's membership to regional trading blocks					
2	The digital divide, educational, purchasing power difference between Kenya and the importing country					
3	Regulatory and commerce infrastructure in the importing country					
4	Currencies and clearing system as well as banking and financial networks					
5	Intellectual property e.g. Copyright laws					
6	Government policies in such areas as R&D, security					
7	A country's culture					
8	Language, education, and technical infrastructure					
	Industry specific factors					
9	Importation barriers					
10	Lack of innovativeness and efficiency in the firm					
11	Level of competition in the sector					
12	Capital, training, and research and development accessibility					
13	Financial capital necessary to become competitive					
14	Structure and culture of the organisation					

9.) How important has each of the following strategic options been to your firm in response to your internationalization process?

Use a scale of 1 – 5 with; 1- Very important, 2 – Fairly important, 3 – Not sure, 4 – Not important and 5 – Not important at all.

a) Focus

FACTORS	1	2	3	4	5
Market focusing					
Market segmentation					

b) Cost leadership

FACTORS	1	2	3	4	5
Use of latest technology					
Cost cutting					
Business process rationalization					
Staff reduction					
Automation of operations					

c) Differentiation

FACTORS	1	2	3	4	5
Customer service					
Increased advertising					
New products/services					
Branding					
Staff training					
More strategic locations					

THANK YOU FOR YOUR TIME