The Importance of Strategic Fit Between Host–Home Country Similarity and Exploration Exploitation Strategies on Small and Medium-Sized Enterprises’ Performance: A Contingency Perspective

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ABSTRACT

The impact of host–home country similarity on firm performance has long been debated in the international marketing literature with inconclusive, if not contradictory, findings. Taking a contingency perspective, this study proposes that a small or medium-sized enterprise’s (SME’s) global market performance depends on the strategic fit between its exploration and exploitation strategies and its host country choice. The results of a survey of chief executive officers and senior international marketing managers of SMEs in the United States show that the impact of host–home country similarity on SMEs’ international performance is moderated by their choice of exploration and exploitation strategies. Specifically, host–home country similarity has a positive impact on an SME’s international performance when the firm adopts an exploitation strategy. Conversely, host–home country similarity has a negative impact on an SME’s international performance when it adopts an exploration strategy. Directly addressing the long-standing host–home country similarity debate in the international marketing literature, this study sheds additional light on the drivers for SMEs’ internationalization success.

Keywords: small and medium-sized enterprises, exploration–exploitation, market selection, host–home country similarity, strategic fit

With the recent proliferation of … export resources throughout the U.S., there’s likely one nearer to your business than you might have imagined, leaving only one last question about getting into exports: Why shouldn’t you?

—Natalie Berg, Forbes

Given competitive pressures, internationalization is no longer an unlikely option for most small and medium-sized enterprises (SMEs) in the United States.
States. Thanks to modern technologies, SMEs are more fully able to participate in the global economy and are certainly encouraged to do so, as Natalie Berg’s quote illustrates. Indeed, in May 2010, the U.S. National Export Initiative announced that it intends to double exports within ten years, and much of this growth is expected to come from SMEs. To that end, the U.S. government has created several initiatives specifically directed toward SMEs to help them in exporting activities (U.S. Department of Commerce 2010).

When an SME’s executives decide to go global, they must choose which countries to target and which internationalization strategies to adopt. Transaction cost economics argues that to minimize uncertainty, enhance flexibility, and reduce costs, firms should target host countries that are geographically similar, socially, culturally, and/or economically similar to the home country (Agarwal and Ramaswami 1992; Klein 1989). Rugman and Verbeke (2004), for example, suggest that approximately 80% of multinational firms’ sales are from regions that are geographically close to their home countries. However, research findings on whether choosing socially/culturally/economically similar countries leads to better performance are inconclusive. For example, Johnson and Tellis (2008) find that choosing culturally similar countries enhances performance, whereas a host of others have reported conflicting results (e.g., Czinkota and Ursic 1987; Granstrand 1999; Mitra and Goldar 2002; Terpstra and Yu 1988). Similarly, Cui, Walsh, and Gallion (2011) find that although many SMEs target socially/culturally/economically similar countries to minimize risk, this strategy does not automatically translate to bottom-line success. The authors observe that entering socially/culturally/economically similar countries is sometimes ill-advised because markets in those countries may be saturated and the competition may be too intense for SMEs with limited resources.

Although firms’ internationalization strategies have been examined extensively in the literature (e.g., Cavusgil and Zou 1994; Hultman, Katsikeas, and Robson 2011; Zou and Cavusgil 2002), recent global economic changes and the increasingly turbulent international marketplace have called for studies to examine how firms’ international marketing strategies influence their performance in the contemporary global market (American Marketing Association 2014). The present study provides an alternative angle from which to examine this market selection debate by proposing that an SME’s global market performance depends on the strategic fit between its exploration and exploitation strategies and the host country choice.

We have opted to conduct our research through the exploration/exploitation lens because proper implementation of these strategies tends to lead to a competitive advantage for SMEs in the global marketplace (Kyriakopoulos and Moorman 2004). Broadly, exploitation has been defined as “the use and development of things already known” and exploration as “the pursuit of knowledge, of things that might come to be known” (Levinthal and March 1993, p. 105). Admittedly, compared with multinational enterprises, SMEs are resource constrained. However, because of their smaller size, SMEs are not bounded by rigid organizational structure and the bureaucratic process of corporate decision making and, thus, are more flexible and responsive to the dynamic international environment (Kamakura, Ramón-Jerónimo, and Gravel 2012). Therefore, SMEs are more inclined to adapt their international marketing strategies quickly on the basis of the external environment in which they are operating. It is particularly relevant to examine SMEs’ international exploration and exploitation strategies because these strategies enable SMEs to swiftly adjust to the ever-changing international marketplace and to compete with larger firms, which may be slower to act due to their highly bureaucratic decision-making process.

In answering the call for research in SMEs’ international marketing strategies, this article makes the following contributions. First, the present study provides a theoretical explanation for the inconclusive findings on the impact of host–home country similarity on firm performance. Examining the host–home country similarity and market selection debate from the theoretical foundation of contingency theory and strategic fit perspective (Cavusgil and Zou 1994; Zou and Cavusgil 2002), we propose that host–home country similarity alone cannot predict a firm’s international market performance. Rather, an SME’s internationalization success depends on the alignment between its host market selection and its implementation of exploration and exploitation strategies.

Second, the present study provides empirical evidence in support of the application of contingency theory and the strategic fit perspective in international marketing studies. Although contingency theory has been discussed extensively in the international marketing strategy literature, it has also been criticized for being too broad and lacking empirical justification (Schoonhoven 1981).
As Hultman, Katsikeas, and Robson (2011) note, few studies have empirically tested the impact of strategic fit on firm performance in the international marketing literature (e.g., Katsikeas, Samiei, and Theodosiou 2006). The present study is an attempt to provide greater theoretical justification for contingency theory by directly testing the moderating effect between host–home-country similarity and SMEs' exploration and exploitation strategies.

Third, by examining international marketing managers’ decisions regarding foreign market selection and international marketing strategies, we aim to provide practical strategic guidance to SMEs' internationalization efforts. Our findings suggest that choosing highly socially/culturally/economically similar countries does not necessarily lead to better performance. International marketing managers of SMEs need to consider market selection in light of their exploration and exploitation strategies. Those SMEs that align market selection and their chosen strategies should perform better than those that fail to do so. Thus, the findings of this study can assist international marketing managers with their market selection decision making and international strategy implementation.

We organize the remainder of the article as follows. First, we briefly review the underlying theories relating to SME internationalization. Then, we present our hypotheses, followed by the research methodology and data analysis results. We conclude with a discussion of our findings and suggestions for further research.

THEORETICAL FOUNDATIONS AND HYPOTHESES

SME Internationalization Theories

Academics have focused on seven broad topics in studying SMEs’ internationalization efforts: mode, timing, intensity and sustainability, influence of the domestic environmental context, leveraging of external resources, unit of analysis differences, and effect of internationalization on SME performance (Wright, Westhead, and Ucbasaran 2007). This body of research has been framed through several theoretical lenses.

Johanson and Vahlne’s (1977, 1990, 2009) Uppsala or incremental model proposes that companies follow stages in their internationalization by leveraging the resources and knowledge they accumulate in the domestic market. Typically, firms choose markets that are psychologically close, and as they gain experience, they move to more distant markets (Johanson and Vahlne 1977, 1990, 2009). According to this theory, it can be assumed that entering markets that are close to the home country has relatively low risk and is likely to lead to success.

Another theoretical angle comes from transaction cost economics. Transaction cost economics models treat market entry decisions using a rational/economic approach, typically through transaction cost analysis (Erramilli and Rao 1993). A firm’s choice of market entry strategy and market choice is a function of choosing the option that minimizes environmental uncertainty and transaction costs (Agarwal and Ramaswami 1992; Klein 1989). Accordingly, to reduce transaction costs and minimize uncertainty, firms should exhibit a preference for host countries that are socially, culturally, economically, or geographically similar to the home country.

Collectively, these theories suggest that to avoid risks from lack of market knowledge and unfamiliar social/cultural environments, SMEs should enter countries that are highly similar to their home country (Brouthers and Nakos 2004; Erramilli and Rao 1993). Ojala and Tyrväinen (2007) support this notion with their finding that SMEs are likely to enter countries that are economically advanced, culturally similar, and geographically close to their home country. Yet whether such a strategy leads to SMEs’ international success still remains unanswered in the international marketing literature. We turn to contingency theory for theoretical insights.

Contingency Theory and Market Selection

Contingency theory originated with the seminal works of Burns and Stalker (1961), Chandler (1962), and Lawrence and Lorsch (1967) and has become well-established in current strategy and international business research (e.g., Hambrick and Canella 2004; Hofer 1975; Liouville 1992; Simion and Hitt 2009). Contingency scholars argue that performance is a function of the congruence between an organization and its environment, strategy, and firm characteristics (Duncan 1972; Miles and Snow 1978; Venkatraman 1989), and “the best way to organize depends on the nature of the environment to which the organization relates” (Scott 1992, p. 89). Thus, the basic premise of contingency theory is that decision makers strive to align their organizational goals with the conditions in their external environments to achieve strategic fit and congruency.
(Lawrence and Lorsch 1967). The advantage of contingency theory is that it embraces all of the aforementioned models, which consider internal and external resources and strategies in varying degrees.

Several researchers have addressed the market selection issue through the contingency argument. Dunning (1980) proposes an “eclectic paradigm of international production” and integrates ownership, location, and internalization factors to explain firms’ international success. Borrowing from this framework, Brouthers, Brouthers, and Werner (1999) demonstrate that firms that select internationalization strategies in accordance with the level of ownership, location, and internalization advantages perform better than those that do not.

Beyond the notion of international decision making being contingent on an SME’s internal and external situation, scholars have also identified countries’ distinctive cultural and institutional heritage as factors in market entry choice (Hofstede 1991, 1994; Schneider and DeMeyer 1991). Instead of following the industry trend to go after the “most popular” markets, firms should evaluate their own strategies, resources, and advantages and choose markets that best “fit” their competitive advantage (Cavusgil and Zou 1994; Kumar and Subramaniam 1997; Zou and Cavusgil 2002). This strategic “fit” or congruency, defined as the internal consistency or match of two or more strategic factors (Van de Ven and Drazin 1985), helps the firm maximize the possibility of international success and avoid potential environmental risks. Likewise, Kumar and Subramaniam’s (1997) contingency model of market entry suggests that firms should not only focus on the external factors but also evaluate the internal characteristics of the firm and align external factors with internal strategies.

**Does Host–Home Country Similarity Lead to Market Success?**

A particular focal point of research on firms’ international success has been the similarities between host and home countries. Scholars have focused on topics including social cultural distance (Dow and Larimo 2009; Solberg 2008), institutional difference (Homburg et al. 2009), economic factors (Ojala and Tyrväinen 2007; Tsang and Yip 2007), and political and legal differences (Henisz and Zelner 2005).

Much of this work on the relationship between host–home country similarity and SMEs’ international performance has been framed in terms of overcoming distance to target markets through varying definitions of “distance.” Johnson and Tellis (2008) show that firms have a higher success rate entering culturally close countries than culturally distant countries. Other authors have supported this finding using similar constructs, including commitment (Hadjikhani 1997), knowledge (Johanson and Vahlne 1977), psychic distance (Johanson and Wiedersheim-Paul 1975; Sousa and Lengler 2009), and economic-institutional distance (Dow and Karunaratna 2006; Henisz, Mansfield, and Von Glinow 2010; Henisz and Zelner 2005).

However, some researchers have refuted the impact of host–home country similarity on SME performance. Although distance effects can be observed at the country or macro level, Terpstra and Yu (1988) do not observe similar effects at the firm level, and Engwall and Wallenstal (1988) find conflicting results using a different sample of firms in the same country. Johanson and Wiedersheim-Paul (1975) report that psychological distance effects that are valid in one country do not seem to exist in other countries. This finding has been subsequently confirmed by Mitra and Golder (2002), Granstrand (1999), and Sullivan and Baureschmidt (1990). Benito and Gripsrud (1992) show that the impact of host–home country similarity depends on mode of entry (exporting vs. direct investment). Finally, in a meta-analysis featuring 66 independent samples, Tihanyi, Griffith, and Russell (2005) record that cultural distance is inconsistently a significant factor. In short, there have been inconclusive, if not contradictory, findings on host–home country similarity and SME performance. For a summary of this stream of literature on host–home country similarity, see Table 1.

In light of these contradictory findings, the premise of this research is to offer an alternative perspective. We argue that SMEs’ international market performance is a function of both strategy and market selection alignment. Specifically, we examine the seemingly conflicting findings from the contingency perspective of strategic fit between host–home country similarity and two important international marketing strategies: exploration and exploitation.

**SMEs’ Exploration and Exploitation Strategies**

March (1991) first proposed the importance of exploration and exploitation to organizational learning and, with Levinthal, defined exploitation as “the use and development of things already known” and exploration as “the pursuit of knowledge, of things that might come to be known” (Levinthal and March 1993, p. 105). Since the introduction of the exploration–
exploitation constructs, other authors have extended the notion into many facets of business, including marketing strategy and capability (Tu 2010; Vorhies, Orr, and Bush 2010), new product success (Atuahene-Gima 2005; Lisboa, Skarmeas, and Lages 2011; Molina-Castillo, Jimenez-Jimenez, and Munuera-Aleman 2011; Zhang, DiBenedetto, and Hoenig 2009), and organizational theory (Lisboa, Skarmeas, and Lages 2011). Others have considered the antecedents/consequences of this construct, including managerial style (Visser, Faems, and Top 2011), entrepreneurial networks (Knight 2000; Vasilchenko and Morrish 2011), external environment (Auh and Menguc 2005), knowledge acquisition (Mom, Van Den Bosch, and Volberda 2007), personnel and hiring policies (Groysberg and Lee 2009), and sustainability (Maleti et al. 2014).

<table>
<thead>
<tr>
<th>Study (Year)</th>
<th>Countries</th>
<th>N</th>
<th>Operationalization of Host–Home Country Similarity</th>
<th>Impact of Host–Home Country Similarity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Benito and Gripsrud (1992)</td>
<td>Norway</td>
<td>93</td>
<td>Cultural distance</td>
<td>Mixed</td>
</tr>
<tr>
<td>Brock, Johnson, and Zhou (2011)</td>
<td>United Kingdom, Germany, and United States</td>
<td>303</td>
<td>External and internal distance</td>
<td>Significant</td>
</tr>
<tr>
<td>Czinkota and Ursic (1987)</td>
<td>United States</td>
<td>190</td>
<td>Cultural distance</td>
<td>Insignificant</td>
</tr>
<tr>
<td>Dow and Karunaratna (2006)</td>
<td>38 countries</td>
<td>38</td>
<td>Economic and psychic distance</td>
<td>Mixed</td>
</tr>
<tr>
<td>Dow and Larimio (2009)</td>
<td>Nordic countries</td>
<td>1502</td>
<td>Economic distance</td>
<td>Significant</td>
</tr>
<tr>
<td>Ellis (2008)</td>
<td>China</td>
<td>458</td>
<td>Geographic, cultural, and psychic distance</td>
<td>Insignificant</td>
</tr>
<tr>
<td>Engwall and Wallenstal (1988)</td>
<td>Sweden</td>
<td>N.A.</td>
<td>Geographic proximity</td>
<td>Insignificant</td>
</tr>
<tr>
<td>Granstrand (1999)</td>
<td>Japan and Sweden</td>
<td>43</td>
<td>Psychic distance</td>
<td>Insignificant</td>
</tr>
<tr>
<td>Hadjikhani (1997)</td>
<td>Sweden and Iran</td>
<td>9</td>
<td>Tangible and intangible commitment</td>
<td>Significant</td>
</tr>
<tr>
<td>Johanson and Wiedersheim-Paul (1975)</td>
<td>Sweden</td>
<td>4</td>
<td>Psychic distance</td>
<td>Significant</td>
</tr>
<tr>
<td>Johnson and Tellis (2008)</td>
<td>China and India</td>
<td>192</td>
<td>Cultural proximity</td>
<td>Significant</td>
</tr>
<tr>
<td>Perks, Hogan, and Shukla (2013)</td>
<td>Thailand</td>
<td>139</td>
<td>Cultural distance</td>
<td>Insignificant</td>
</tr>
<tr>
<td>Solberg (2008)</td>
<td>Norway</td>
<td>173</td>
<td>Cultural distance</td>
<td>Significant</td>
</tr>
<tr>
<td>Sousa and Lengler (2009)</td>
<td>Brazil</td>
<td>201</td>
<td>Psychic distance</td>
<td>Significant</td>
</tr>
<tr>
<td>Sullivan and Bauerschmidt (1990)</td>
<td>Sweden and Finland</td>
<td>52</td>
<td>Psychic distance</td>
<td>Insignificant</td>
</tr>
<tr>
<td>Terpstra and Yu (1988)</td>
<td>United States</td>
<td>20</td>
<td>Geographic proximity</td>
<td>Insignificant</td>
</tr>
<tr>
<td>Tihanyi, Griffith, and Russell (2005)</td>
<td>66 independent sample meta-analysis</td>
<td>66</td>
<td>Cultural distance</td>
<td>Mixed</td>
</tr>
</tbody>
</table>

Notes: N.A. = not applicable.
The concepts of exploration and exploitation have been widely adopted in various contexts. Baum, Li, and Usher (2000, p. 768) explain the activities that lead to exploitation as “learning gained via local search, experiential refinement and selection and reuse of existing routines,” whereas exploration involves “learning gained through processes of concerted variation, planned experimentation and play.” Benner and Tushman (2003) apply exploration and exploitation to firm innovation and argue that exploitative innovation involves improvement in existing technology and components, whereas exploratory innovation often requires a shift in the current technology and procedure. In a marketing context, exploitation and exploration can be examined at both the product and market levels. Exploitation of existing products involves refinement of product features (e.g., Apple increases the screen size for the iPhone 6), enhancement of efficiency, and extension of the life cycle of a product (Tushman and Smith 2002). In so doing, firms may achieve exploitation of the current market by enhancing customer loyalty, improving customers’ satisfaction level, and increasing the lifetime value of current customers (Voss and Voss 2013). In contrast, exploration of products entails new product development (e.g., Apple develops the Apple Watch), technological innovation, and extensive investment in research and development. Accordingly, firms can develop and serve new customers with their market exploration strategies (Tushman and Smith 2002; Voss and Voss 2013).

Research on exploration and exploitation often yields conflicting results. For example, whereas some researchers (Kyrriakopoulous and Moorman 2004; Rothaermel and Alexandre 2009) have found that an exploitation strategy drives performance, others (Park, Chen, and Gallagher 2002) have found exploration to be a driver of performance. In addition, some studies have shown that these constructs are inversely related to each other (e.g., Voss, Sirdeshmukh, and Voss 2008) and thus only require a single measure (Lavie, Stettner, and Hotho 2010). However, other studies have argued for an orthogonal relationship between exploration and exploitation (Gupta, Smith and Shalley 2006; Russo and Vurro 2010; Sinkula, Baker, and Noordewier 1997). Combined and coined “ambidextrousness,” researchers view exploitation and exploration as complementary to each other as opposed to diametric opposites (Gibson and Birkinshaw 2004; Moorman and Slotegraaf 1999). Gupta, Smith, and Shalley (2006) suggest that in the current economy, in which technology and innovation become obsolete quickly, firms must simultaneously conduct research and development for new products (exploration) while prolonging the life cycle of existing products (exploitation). The authors also propose that although exploration and exploitation fight for resources, the types of resources required for these two strategies are different (e.g., the depth and scope of learning argument by Katila and Ahuja 2002). Thus, although there is debate on the continuity or orthogonality of exploration and exploitation (particularly the validity of the concept; see Chang, Hughes, and Hotho 2011), research has mostly supported the idea that these are separate constructs and that a firm could implement both strategies simultaneously in a given market.

As we have discussed, a firm’s exploration strategy is characterized by actively pursuing opportunities, taking risks, and innovating, whereas the exploitation strategy involves improving the current practice, enhancing efficiency, and capitalizing on existing knowledge (Lisboa, Skarmelas, and Lages 2013; Özsomer and Gençtürk 2003). These distinctive strategies guide SMEs’ internationalization through different market selection routes.

Small and medium-sized enterprises that successfully implement international exploration strategies excel in acquiring new knowledge, developing new products, discovering underserved segments, and relentlessly exploring unknown markets (Cegarra-Navarro, Sánchez-Vidal, and Cegarra-Leiva 2011; Danneels 2008; Freeman and Cavusgil 2007; Lisboa, Skarmelas, and Lages 2013; March, 1991; Özsomer and Gençtürk 2003). When expanding internationally, they are likely to move away from their comfort zone of existing practices and products/services. As such, their bold internationalization moves and expansion into unfamiliar, less saturated markets should lead to enhanced international performance. Indeed, Lisboa, Skarmelas, and Lages (2013) show that market exploration improves performance under high levels of export market turbulence.

In contrast, SMEs that adopt international exploitation strategies focus on improving and leveraging the firms’ current knowledge and practice (Danneels 2008; Lisboa, Skarmelas, and Lages 2013; March 1991; Özsomer and Gençtürk 2003). These firms internationalize by extending their existing products/services, serving similar segments, prolonging the product life cycles of current product lines, and investing in familiar markets (Lisboa, Skarmelas, and Lages 2013). These strategies require limited resources and investment and, thus, are attractive to resource-constrained SMEs. Consequently, they achieve international performance by leveraging...
their existing knowledge and economies of scale (Lisboa, Skarmees, and Lages 2013).

**Strategic Fit Between Exploration and Exploitation Strategies and Market Selection**

The strategic fit between SMEs’ international exploration and exploitation strategies and host–home country similarity is critical to SMEs’ internationalization because this alignment enables firms to take full advantage of their respective strategies. According to Zou and Cavusgil (2002, p. 42), a firm’s global market performance is influenced positively by its global marketing strategy, defined as “the degree to which a firm globalizes its marketing behaviors in various countries through standardization of the marketing-mix variables, concentration and coordination of marketing activities, and integration of competitive moves across the markets.” A firm’s global financial and strategic performance depends on the fit between its global marketing strategy and the market selection decisions (Boso et al. 2013; Cavusgil and Zou 1994; Gabrielson, Gabrielson, and Seppäl 2012; Hultman, Robson and Katsikeas 2009; Murray, Kotabe, and Westjohn 2009; Zou and Cavusgil 2002).

It is consistent with the strategic fit perspective that an SME should align its exploitation strategy with country choices that enable it to capitalize on its current knowledge/skills and existing products/services (Cavusgil and Zou 1994; Zou and Cavusgil 2002). Countries that are most similar (in terms of culture, business culture, political/institutional factors, and economic development) to the SME’s home country provide unique opportunities for it to leverage its current knowledge and skills with minimal change (Danneels 2008; Kumar and Subramaniam 1997; Lisboa, Skarmees, and Lages 2013; Özsomer and Gençtürk 2003). Countries that bear a high level of host–home country similarity become a logical and attractive option to exploitation-oriented SMEs. These countries allow for reduced cost through standardization and economies of scale, additional profit through an extended product life cycle of existing products/services, and minimized risks owing to relatively familiar social, cultural, environmental, and institutional factors (Danneels 2008; Lisboa, Skarmees, and Lages 2013; Özsomer and Gençtürk 2003). Consequently, host–home country similarity is likely to have a positive influence on SMEs’ international performance when the firms adopt an exploitation strategy in their international market (see Figure 1). Therefore, we hypothesize the following:

\[ H_1: \text{Host–home country similarity has a positive impact on an SME’s international performance} \]

when the firm adopts an exploitation strategy.

In contrast, SMEs that adopt exploration strategies are willing to take the risk of acquiring new knowledge and skills and challenging their current marketing practices. Countries that are dissimilar (in terms of culture, business culture, political/institutional factors, and economic development) to their home market provide opportunities for exploration-oriented SMEs to maximize their relative advantage in creating new products, developing new markets, and engaging in innovation (Danneels 2008; Lisboa, Skarmees, and Lages 2013; Özsomer and Gençtürk 2003). Therefore, these SMEs are likely to succeed in exploring unknown and underserved markets and are often able to seize opportunities in dissimilar countries. Adapting to a new environment and being responsive to changing market needs help these firms sustain their competitive advantage in dissimilar markets, ultimately leading to enhanced performance (Kumar and Subramaniam 1997). We posit, however, that countries with a high level of host–home country similarity may work to prohibit exploration-oriented SMEs from leveraging their knowledge and skills to form a competitive advantage. Under this scenario, host–home country similarity may negatively influence an SME’s international performance when it adopts an exploration strategy (see Figure 1). Thus, we propose the following hypothesis:

\[ H_2: \text{Host–home country similarity has a negative impact on an SME’s international performance} \]

when the firm adopts an exploration strategy.

**RESEARCH METHODOLOGY**

To test the hypotheses, we developed a survey drawing on a thorough literature review and insights from a qualitative study of three international SMEs. We outsourced data collection to a large marketing research firm, which sent an online questionnaire to its national panel of 1,660 chief executive officers (CEOs) and senior international marketing managers of SMEs in the United States. We received 238 responses, constituting a response rate of 14.3%. We deleted incomplete responses and data from firms with more than 500 employees from the final data set (following the Small Business Administration’s definition of SMEs as firms with 500 employees or fewer), leaving 135 usable responses. From a projection of the collected data, we estimate that 34% of the originally sampled firms have more than 500 employees.
Removing these firms from the sampling frame yields an effective response rate of 12.3%. We checked non-response bias by comparing data collected at the beginning of the data collection process (the first 33%) with data collected at the end (the last 33%) on four key variables—performance ($t = -0.45, p > .05$), country similarity ($t = -0.53, p > .05$), exploitation strategy ($t = -0.46, p > .05$), and exploration strategy ($t = 0.60, p > .05$)—as well as on firm variables such as years of global experience ($t = 0.59, p > .05$), percentage of sales from overseas ($t = 1.06, p > .05$), and number of countries entered ($t = 0.60, p > .05$). We observed no significant differences (Armstrong and Overton 1977).

**Sample**

On average, the firms surveyed had 141.7 employees, with 12.3% of their employees hired outside the United States. They had been operating for an average of 48.2 years and had 28.2 years of international marketing experience. An average firm sold 52.1% of its total product lines to 20.5 countries, with 34.2% of total sales coming from foreign markets. In terms of host–home country similarity, 43.3% reported lower than midpoint scores on country similarity and 43.1% reported higher than midpoint scores, with 13.6% scoring a four on a seven-point scale. Approximately 40.3% of all respondents held job titles listing them as president and CEO; the remainder were senior international marketing managers, senior international sales managers, and other managers; 58.1% of all respondents reported speaking at least one foreign language; 82.9% had a bachelor’s degree or higher; and 76.9% were male (for detailed information on sample characteristics, see Table 2).

**Measures**

To develop the survey, we used existing scales, with some items adapted to the context of this inquiry (see the Appendix). Respondents evaluated their firm’s most recent international market entry using the scales described in the following subsections (in line with the

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**Figure 1. Hypothesized Relationships Among Constructs**

![Diagram](image)
Importance of Strategic Fit on SMEs’ Performance

Method used by Morgan, Katsikeas, and Vorhies [2012] and Zou and Cavusgil [2002]).

Exploration and Exploitation Strategies. We adapted measures for the SME’s exploration strategy (composite reliability = .76) and exploitation strategy (composite reliability = .63)\(^1\) from Kyriakopoulos and Moorman (2004) and Yalcinkaya, Calantone, and Griffith (2007). For the significant loadings for each construct (\(p < .05\)), see the Appendix.

Host–Home Country Similarity. We measured the similarity between the targeted country and the United States (composite reliability = .91) on four dimensions: culture (Dow and Larimo 2009; Solberg 2008), business culture (Homburg et al. 2009), political system (Henisz, Mansfield, and Von Glinow 2010; Henisz and Zelner 2005), and economic development (Ojala and Tyrväinen 2007; Tsang and Yip 2007). All items significantly loaded on the host–home country similarity construct (\(p < .05\)). For the loadings, see the Appendix.

International Performance. We measured SMEs’ international performance using a three-item scale (composite reliability = .86) adopted from Moorman (1995). By assessing performance as the success of a firm relative to its international competitors, this measure eliminates variance and distortion created by product categories/market differences.

Control Variables. We measured four control variables: percentage of products sold overseas, employee number, years of global experience, and number of countries entered.
Common Method Bias Test. Common method bias is created when variance is “attributable to the measurement method rather than to the constructs the measures represent” (Podsakoff et al. 2003, p. 879). Common method bias may pose a problem with self-reported data because respondents may have a propensity to provide consistent answers or because the data are collected from a single informant per firm. To avoid potential common method bias, we adopted several ex ante procedures recommended by Chang, Van Witteloostuijn, and Eden (2010). We first included a statement in the cover letter of the survey assuring respondents of the anonymity and confidentiality of the study and that there were no right or wrong answers. We then carefully designed the survey by counterbalancing the order and types of questions. Finally, we randomized the order of the questions appearing on the same page of the online survey using an item randomizer.

To test for common method bias ex post, we employed the partial correlation procedure of including a marker variable within the model (Lindell and Whitney 2001). For testing purposes, we used the gender of the respondents. We reverse-coded gender to remove the negative signs in the correlations, and no correlations became insignificant after reflecting the marker variable. We examined the correlations of the marker variable and all the other variables. As suggested by Malhotra, Kim, and Patil (2006), we used the lowest positive correlations of the marker variable and the other variables as an estimate of Rm (Rm1 = .07). Then, we partialled out this correlation from all other correlations to compare the original and common method variance–adjusted correlations. These correlations were not significantly different from the original correlations, suggesting that common method variance was not a serious threat.

Measure Validation. We used measure validation procedures outlined by Anderson and Gerbing (1988) and conducted confirmatory factor analysis to determine the convergent and discriminant validity of the first-level constructs. We achieved satisfactory goodness-of-fit indices for the overall measurement model ($\chi^2(38) = 71.1, p < .01$; root mean square error of approximation = .045; normed fit index = .94; comparative fit index = .98; incremental fit index = .98). Significant factor loadings ($p < .001$) provide support for convergent validity for each construct. In further support of internal consistency, the reliability of each scale exceeded .60, and the average variance extracted exceeded .50 for all constructs.

We used Fornell and Larcker’s (1981) method to assess discriminant validity. The average variance extracted exceeded the squared correlations of each pairwise relationship. In addition, the correlations among the constructs are comparatively low (see Table 3), with the highest correlation found between performance and exploitation capability ($r = .34$). Jointly, these results indicate satisfactory reliability and validity for our measures.

Results

We tested the moderating effects hypothesized in H1 and H2 using multiple regression analyses. Following Cohen et al.’s (2003) guidelines, we mean-centered the exogenous variables to avoid problems with multicollinearity. The variance inflation factors confirmed that multicollinearity is not a threat to the findings of this study (all variance inflation factors < 3). We examined the moderating effects hypothesized in H1 by adding the cross-product between host–home country similarity and exploitation strategy into the regression model. To test H2, we added in the same model the cross-product

### Table 3. Means, Standard Deviations, and Correlations

<table>
<thead>
<tr>
<th></th>
<th>M</th>
<th>SD</th>
<th>Composite Reliability</th>
<th>Exploitation Strategy</th>
<th>Exploration Strategy</th>
<th>Country Similarity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exploitation strategy</td>
<td>4.43</td>
<td>1.26</td>
<td>.63</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Exploration strategy</td>
<td>3.99</td>
<td>1.41</td>
<td>.76</td>
<td>.22*</td>
<td>.07</td>
<td>-.09</td>
</tr>
<tr>
<td>Country similarity</td>
<td>3.95</td>
<td>1.34</td>
<td>.91</td>
<td>.07</td>
<td>-.09</td>
<td></td>
</tr>
<tr>
<td>Performance</td>
<td>3.63</td>
<td>1.42</td>
<td>.86</td>
<td>.23*</td>
<td>.34*</td>
<td>-.06</td>
</tr>
</tbody>
</table>

*p < .05.
of host–home similarity and exploration strategy. We included as control variables the percentage of products sold overseas, number of employees, years of global experience, and number of countries entered. We conducted data analysis with SPSS 21. There was a significant positive moderating effect between host–home country similarity and exploitation strategy on SMEs’ international market performance (β = .24, t = 2.63, p < .05) and a significant negative moderating effect between host–home country similarity and exploration strategy on SMEs’ international market performance (β = –.30, t = –3.28, p < .01) (see Table 4). A significant R-square change indicated that the interaction term explains an additional 12% of the variation in the dependent variable ($R^2_\Delta = .12$, $\Delta F(9, 81) = 5.40$, p < .00), in support of both H1 and H2.

To test the robustness of our model and solve the potential endogeneity issue of our focal construct, host–home country similarity, we conducted a robustness test using the residual (saved by regressing exploration strategy and exploitation strategy on host–home country similarity) to partial out any effect of the two moderators on host–home country similarity. We first ran a regression model using host-country similarity as the dependent variable and exploration strategy and exploitation strategy as independent variables. After saving the standardized residuals, we then calculated the products of the standardized residual and exploitation strategy and exploitation strategy. We conducted the same multiple regression with the residual and the interaction terms. The results confirm that there is a significant negative moderating effect between host–home country similarity and exploration strategy (β = –.27, t = –3.24, p < .01) and a significant positive moderating effect between host–home country similarity and exploitation strategy (β = .25, t = 2.92, p < .05) on SMEs’ international market performance. These results show that even when we partial out the effect of exploitation strategy and exploitation strategy on host–home country similarity, the results from the original hypothesis testing remain consistent, lending support to both H1 and H2.

**DISCUSSION AND IMPLICATIONS**

In the ever-changing, increasingly competitive international marketplace, target country choice is an important decision for SMEs. The present study is an attempt to address the seemingly contradictory findings regarding host–home country similarity on SMEs’ global market performance. We find that the impact of host–home country similarity on SMEs’ international performance is moderated by their choice of strategy: exploitation versus exploration. In so doing, we respond to the call for studies that explore how firms’ international marketing strategies influence their performance in the con-

<table>
<thead>
<tr>
<th>Table 4. Results of Regression Analysis</th>
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</thead>
<tbody>
<tr>
<td><strong>Independent Variables</strong></td>
</tr>
<tr>
<td>Country similarity</td>
</tr>
<tr>
<td>Exploitation strategy</td>
</tr>
<tr>
<td>Exploration strategy</td>
</tr>
<tr>
<td>Exploitation strategy x country similarity</td>
</tr>
<tr>
<td>Exploration strategy x country similarity</td>
</tr>
<tr>
<td><strong>Control Variables</strong></td>
</tr>
<tr>
<td>Percentage product</td>
</tr>
<tr>
<td>Employee number</td>
</tr>
<tr>
<td>Years global</td>
</tr>
<tr>
<td>Country number</td>
</tr>
</tbody>
</table>

Notes: Model fit adjusted $R^2 = .31$, $F = 5.40$, p < .000.
temporary global market. Next, we present a synopsis of the important theoretical and managerial contributions of our research.

**Theoretical Implications**

Theoretically, our findings provide support for contingency theory and the strategic fit perspective. Small and medium-sized enterprises’ international performance is influenced by the fit or congruency between their chosen strategies and host–home country similarity. According to Hultman, Katsikeas, and Robson (2011), contingency theory has long been criticized for being too descriptive and broad (e.g., Ozsomer and Simonin 2004; Sousa and Lengler 2009). The present study offers theoretical justification for the application of contingency theory and the strategic fit argument in the international marketing arena. Instead of focusing on the direct impact of market selection on performance, this study empirically tests whether an SME’s international market performance is dependent on its alignment between its international strategies and choice of foreign markets.

Directly addressing the long-standing host–home country similarity debate, this study deepens understanding of the drivers for SMEs’ internationalization success. Whereas some studies (e.g., Dow and Karunaratna 2006; Henisz, Mansfield, and Von Glinow 2010; Henisz and Zelner 2005; Johnson and Tellis 2008;) have found that entering socially, culturally, and economically close countries enhances performance, others have reported insignificant or mixed findings (e.g., Bell, McNaughton, and Young 2001; Benito and Gripsrud 1992; Czinkota and Ursic 1987; Granstrand 1999; Knight and Cavusgil 1996; Mitra and Golder 2002). Our findings suggest that the insignificant relationship between host–home country similarity and performance previously reported could be explained by the interaction between SMEs’ exploration and exploitation strategies and their market selection decisions. Entering countries that are highly similar to the home country in terms of culture, institutional factors, economic development, and business structures does not necessarily lead to enhanced international market performance if the SME’s strategy is not consistent with that market choice. We find that SMEs pursuing exploration strategies are likely to succeed in countries that have a low level of host–home country similarity, whereas firms focusing on exploitation strategies should observe enhanced performance in countries that bear a high level of host–home country similarity. By examining the moderating effect between SMEs’ international marketing strategies and market selection on firm performance, the present study provides an alternative angle from which explain the conflicting results reported in the literature.

Our research also adds to an emerging stream of literature on how SMEs overcome internationalization barriers and achieve global success (Brouthers and Nakos 2004; Cegarra-Navarro, Sánchez-Vidal, and Cegarra-Leiva 2011; Kamakura, Ramón-Jerónimo, and Gravel 2012). Previous studies have found that resource-constrained SMEs often turn to countries that are physically close and culturally similar to avoid risks and reduce market uncertainty (Johnson and Tellis 2008). However, our findings suggest that simply following this trend by targeting countries with a high level of host–home country similarity may not help SMEs overcome market barriers. To the contrary, we illustrate that SMEs’ international success depends, to a large extent, on the strategic fit between their exploration and exploitation strategies and market selection decisions. For SMEs pursuing an exploration strategy, countries that are dissimilar to the home country may provide the firm a unique opportunity to convert its internal resources and capabilities into market success. Therefore, our study broadens understanding of the complexity of how SMEs deal with the ever-changing international marketing environment. The finding of a significant interaction relationship between host–home country similarity and exploration and exploitation strategies on SME performance marks an important contribution to the SME market selection literature.

**Managerial Implications**

From a managerial viewpoint, many SMEs are inclined to enter countries that bear a high level of similarity to their home country to avoid the potential risks associated with an unfamiliar market, distant culture, different political and legal systems, and low levels of economic development. Our results suggest that this is not always a prudent approach. What seems to matter more in international success is the degree of congruency between a firm’s marketing strategy and its host country choice. For SMEs that are more adept at adopting new processes as well as new products and services, an exploration strategy seems to be most appropriate. Thus, these firms should select host countries that are dissimilar from their home market, thereby enabling them to maximize their competitive advantage in terms of seek-
ing new knowledge, exploring unknown and underserved markets, and seizing overlooked opportunities. In contrast, SMEs that are capable of continuously improving their resources and processes should adopt an exploitation strategy when they approach the international market. For these exploitation-oriented SMEs, choosing host countries that are similar to their home market enhances their international performance. This strategy helps them maximize their existing knowledge and achieve economies of scale from the extension of their current products/service to foreign markets.

Unlike large multinational enterprises, SMEs have fewer tangible and intangible resources and are thus more vulnerable to challenges arising from the international market (Brouthers and Nakos 2004; Erramilli and Rao 1993). To avoid risks from the lack of market knowledge and unfamiliarity with social and cultural factors, some SMEs tend to prefer to enter countries that are highly similar to their home country. Entering countries with high host–home country similarity without regard to a chosen strategy can lead to suboptimal performance. International marketing managers who have a solid understanding of their firms’ exploration and exploitation strategies and who choose host countries that are consistent with their strategy are likely to enjoy greater marketplace success.

Our findings are directly relevant not only to SMEs but also to government policy makers and export assistance agencies. Beyond government-driven goals and desires (e.g., the U.S. National Export Initiative to double U.S. exports), SMEs are increasingly competing in a global marketplace. Internationalization is no longer optional for most SMEs in the United States, and bedrock to any internationalization initiative is deciding which country or countries to target. Thus, government policy makers offer SMEs considerable support through numerous governmental agencies and private businesses to provide essential services and programs. For example, in the United States, governmental agencies include the U.S. Department of Commerce, the International Trade Administration (a bureau of the Department of Commerce), and the U.S. Commercial Services (whose primary mission is to develop and offer services and programs for nonexporting and novice SME exporters). U.S. Commercial Services provides direct contact and consultation by trained trade specialists in 107 U.S. cities and 80 foreign countries. Yet informal analyses of the aforementioned organizations’ web-based information indicate their advice is devoid of information relating to strategy (exploitation/exploration) and target country (dis)similarity. Given that SMEs turn to these agencies for advice and information, it is critical that cutting-edge insights reach them through these services.

LIMITATIONS AND FURTHER RESEARCH

Although our study provides several new insights into SMEs’ internationalization, additional research must still be undertaken. First, our study was conducted in the United States, which limits its generalization to other contexts. Future studies should include SMEs from other countries. Although the literature has suggested that country selection criteria are relatively stable across countries, our findings would be strengthened if future work replicated our findings in other countries or regions of the world.

Second, we intentionally focused on two internationalization strategies: exploration and exploitation. As many other studies have suggested, other internationalization strategies may also explain SMEs’ global performance. An emerging body of research suggests that firms must be ambidextrous and, thus, capable of implementing both exploration and exploitation strategies (Cegarra-Navarro and Dewhurst 2007; Gedajlovic, Cao, and Zhang 2012). Further research should consider ambidexterity as an alternative strategy to the sole use of either exploration or exploitation.

Third, this research was conducted at the firm level without regard to width and breadth of product lines. For our study, respondents were asked to report on their most recent international entry. The SMEs surveyed range in size from very small to 500 employees. It is reasonable to assume that firms on the higher end of this range might have had multiple product lines. It is possible that firms with multiple product lines might implement global strategies differently than firms with fewer product lines. Narrowing our focus to the product-line level could enhance our research model. In addition, the research model might be further refined by incorporating other firm-level variables such as organizational structure, top-management involvement, and other environmental factors (e.g., market structure, market turbulence, consumer culture, market attractiveness).

The data collected in this study are cross-sectional. Future studies could adopt a longitudinal approach and examine how the proposed relationships change over time. For example, SMEs may take different strategies at various internationalization stages. Longitudinal data
would help uncover the impact of different stages on strategy deployment and country choice. In addition, we measured exploration and exploitation using two-item scales adapted from the literature (Kyriakopoulos and Moorman 2004; Yalcinkaya, Calantone, and Griffith 2007). Further research could develop multi-item measures for these constructs.

Finally, whereas the present study examined exploration and exploitation as moderators of the relationship between host–home country similarity and performance, an alternative model could consider exploitation and exploration strategies as antecedents to SMEs’ internationalization decisions. It might be true that SMEs select exploration/exploitation strategies first and then choose their target country. Theoretically, determining which construct serves as antecedent would be a worthwhile topic for further investigation.

Although our results provide a strong theoretical and empirical foundation for understanding the dynamics among SMEs’ exploration and exploitation strategies, host-country choices, and performance, our study represents only an initial formulation. Further research along the described lines would increase understanding of the dynamic and ever-changing internationalization behavior of SMEs.

NOTE
1. Because exploration and exploitation strategies were each measured with a two-item scale, we report composite reliability instead of Cronbach’s alpha. In addition, the reliability and validity tests show satisfactory results.

Appendix. Scale Items Used in Survey

<table>
<thead>
<tr>
<th>Scale Items</th>
<th>λ</th>
<th>ItTC</th>
<th>CA</th>
<th>CR</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Exploitation Strategy</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Our firm focuses on improving the firm’s existing processes, products and services in our international markets.</td>
<td>.88</td>
<td>—</td>
<td></td>
<td>.76</td>
</tr>
<tr>
<td>Our firm’s international strategy focuses on selling current products/service as opposed to developing new products/service.</td>
<td>.84</td>
<td>—</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Exploration Strategy</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Our firm chooses new approaches to develop processes, products and services that are different from those used in the past in our international markets.</td>
<td>.83</td>
<td>—</td>
<td></td>
<td>.63</td>
</tr>
<tr>
<td>Instead of focusing on the current product and service, we engage in developing new products and service for our international markets.</td>
<td>.75</td>
<td>—</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Host–Home Country Similarity</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>The country we enter has similar cultures as the U.S.</td>
<td>.93</td>
<td>.84</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The country we enter has similar business cultures as the U.S.</td>
<td>.91</td>
<td>.87</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The country we enter has similar political and legal system as the U.S.</td>
<td>.88</td>
<td>.79</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The country we enter is [as] economically developed (as the U.S.).</td>
<td>.80</td>
<td>.63</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Performance</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Our market share relative to our major international competitors</td>
<td>.93</td>
<td>.80</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Our sales relative to our major international competitors</td>
<td>.92</td>
<td>.85</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Our profit margins relative to our major international competitors</td>
<td>.72</td>
<td>.49</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

1 = “Strongly disagree,” and 7 = “Strongly agree.”
2 = “Very much lower,” and 7 = “Very much greater.”
Notes: ItTC = item-to-total correlation; CA = Cronbach’s alpha; CR = composite reliability. Confirmatory factor analysis goodness-of-fit indices: comparative fit index = .98; normed fit index = .94; incremental fit index = .98; root mean square error of approximation = .045, χ²(38) = 71.1, p < .01.
REFERENCES


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