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# Mode of Entry Strategy on SMEs Internationalization in East Java: A Review of Literature

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## Authors' contributions

*This work was carried out in collaboration among all authors. All authors read and approved the final manuscript.*

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## ABSTRACT

This study review the internationalization of SMEs in East Java from a literature and empirical perspective with the aim of providing in-depth knowledge based on the existing literature and supported by empirical data generated from previous research. This study uses content analysis of current theories and models coupled with empirical analysis of the internationalization studies of SMEs that have been carried out. There are several theories and models, such as the internalization theory, the eclectic paradigm, the Upsala model, the network perspective that connects the internationalization strategy of SMEs in East Java, and several modes of entry for internationalization. The theory is based on the basic resource-based view and network theory. Documented evidence shows that the internationalization strategy of SMEs in East Java still has many obstacles and challenges. Theoretically, the internationalization strategy related to the mode of entry leads to networking. Empirical data supports that the strategy mostly carried out by SMEs in East Java is networking independently. The results of this study are expected to contribute ideas for policymakers, in this case, the government, to play a more active role with long-term strategies for the success of the internationalization of SMEs in East Java.

**Keywords:** Internationalization; small medium enterprise; mode of entry; strategy; East Java.

## 1. INTRODUCTION

### 1.1 Internationalization of SMEs

Internationalization is a phenomenon that has been intensively researched over the last few decades from a variety of perspectives, including organizational theory, marketing, strategic management, international management, and small business management. Issues such as global decision-making and control, the development of international activities, and factors that favor or do not support internationalization have been studied for large and small businesses. Given the nature of today's market, SMEs are increasingly facing the same international problems as larger companies. For many SMEs, especially those operating in the high-tech and manufacturing sectors, it is no longer possible to act in the market without considering the risks [1] and opportunities identification [2,3] presented by foreign or global competition.

The examination of the internationalization process followed by the company involves several aspects. One of the most important aspects is the mode of entry strategy companies choose when they first decide to internationalize and how their entry mode choices change over time as they penetrate more and more foreign markets. The decision to enter a foreign market should be based on: balancing the risks and benefits of this action. However, evidence suggests that it is also determined by the availability of resources [4,5], the need for control [6], marketing skills [7], innovation [8] and networking [9]. Internationalization not only triggers opportunities but must also address foreign risks and obligations, which refer to the increasing costs of business operations in unfamiliar domains. So it requires knowledge of market knowledge, state image, cultural and institutional differences [10,11].

In the international business literature, mature multinational corporations are dominant, while SMEs especially internationalized ones, attract wider interest. This reflects the fact that several countries, especially those with a balance of payments deficits, have sought to increase the international activities of their SMEs to promote economic growth, reduce unemployment and create a potential for future mini-MNEs [12,1]. Internationalization and innovation plays an important role in the development and sustainability of SMEs [13]. Exports are the

dominant mode of market entry in this process. Exports are also an important strategic initiative in the expansion of many SMEs [14,15] Exporting is the main means for many small companies to internationalize.

Companies engaged in the export business also engage in various inward and related internationalization behaviors that interact [16]. Entering and then developing international markets is difficult for any SME company. Many companies rely on conventional marketing methods and operate on a trial and error basis [17]. The main disadvantage is the lack of information about market opportunities and even the inability of management to find sufficient resources to exploit these opportunities effectively [18].

Economic internationalization accelerated in the post-second world war era and emerged unchallenged until the early 1970s when a new phenomenon of globalization began to emerge. Globalization usually refers to the stage where a company's operations are managed globally, not just in a select few countries. Traditional exports are under increasing pressure while marketing and production conditions change rapidly. As a result, today's enterprises, including SMEs, must respond to the market increasingly fast. Globalization also includes the functional integration of geographically dispersed economic activities. It means something more in terms of scope, content, and intensity of interrelationships, capital, and management involvement and is, therefore, a qualitative extension of internationalization [19,1]. Although studies on the internationalization of SMEs arrive at different normative implications about which internationalization strategy to pursue, decision internationalization represents an important strategic choice. It is critical to performance and viability [20]. The strategy must be designed according to the conditions of the organization to achieve maximum performance [21].

### 1.2 Internationalization of SMEs in Indonesia

In Indonesia, SMEs have an important and strategic role in advancing the national economy [22]. Data from the Ministry of Cooperatives and SMEs for 2020 shows that the number of SMEs in Indonesia reaches 64.2 million, or equivalent to 99.9% of the total business units in Indonesia. Meanwhile, the contribution of SMEs to Gross National Income (GDP) is 61.07%, and

employment is 97%. By looking at these data, it is clear that the existence of SMEs in Indonesia deserves attention from the government, especially those related to the sustainability of SMEs [23]. SMEs' important and strategic role can be seen clearly through their contribution to expanding and equalizing business opportunities, absorbing labor, and accelerating regional and national economic growth [24]. With their various advantages, SMEs have also grown far in foreign markets by investing in the development of their brands [25]. Therefore, SMEs deserve to be considered in the international market [26]. Internationalization also allows SMEs to survive amidst intense competition [27]. SMEs in Indonesia are increasingly considering international expansion as a strategic option for sustainable growth [28].

Even though SMEs contribute to economic development, they still have big challenges. If these challenges can be overcome with suitable needs to be met, the economy will surely improve. The contribution of SMEs to employment reduces poverty etc. makes the economy grow well. This reduces the crime rate, as it has been provided for those who are unemployed [29]. The challenge faced by SMEs is how to create a competitive advantage through increasingly fierce domestic and global competition [30].

The process of internationalization and globalization is both a threat and an opportunity for SMEs. Potential options include exports, new market entrants, and foreign cooperation, while the threat of increasingly fierce competition persists. The rapid growth of networks and communication between countries provides SMEs opportunities to participate in international market competition. SME products that were previously only available in the local market must be able to improve their quality to meet export standards. Exports positively affect the country's economic development, and exporting companies are generally more productive than non-exporting companies [31].

According to Tricahyadinata [24], SME export barriers in Indonesia include: (1) Trade globalization requires economic actors to be more sensitive to market changes, especially consumer behavior. (2) Product diversification is still lacking in terms of manufactured products' design, form, and functionality. Due to the low diversity of SMEs, SMEs are traditional products/services with comparative advantages,

such as clothing and various other textile products, leather products such as shoes and wood, so they seem to be special in the SME sector. (3) Poor access to productive resources, especially finance, information, advertising, technology, and export product business networks. Another thing that often becomes an obstacle is the international orientation of entrepreneurs, which has a positive relationship with the internationalization strategy [32]. The importance of the internationalization of SMEs in Indonesia and the obstacles that accompany it are interesting things to study and discuss as to what mode of entry strategy is being applied by SMEs in Indonesia in achieving internationalization.

## 2. THEORETICAL LITERATURE

There are several theories and models of internationalization for SMEs in terms of individual companies; the basis of internationalization research can be found in corporate behavior and different theories of decision making. The SME internationalization strategy is inseparable from the mode of entry implementation. The following are some theories and models suitable for SMEs related to the method of entry strategy.

### 2.1 Stage Theory

This theory assumes that the company initially operates in the domestic market and then gradually expands international activities in several stages after reaching a stable position [31].

### 2.2 Eclectic Paradigm

The eclectic paradigm is based on the internalization theory and tries to explain various forms of international production and the selection of countries for FDI (foreign direct investment). FDI is the net inflow of investments operating in other countries to acquire long-term goals [33].

According to Dunning (1988), the internationalization of economic activity is determined by realizing three types of benefits [34]. First, ownership gains are specific to the firm and are related to the accumulation of intangible assets, technological capacity, or product innovation. Second, the advantages of internalization stem from the company's ability to

manage and coordinate activities internally in the value-added chain. Third, location advantage refers to the institutional and productive factors in a particular geographic area. This arises when combining products manufactured in the home country with non-transferable characteristics and intermediate products from other locations is preferable. Dunning's eclectic paradigm addresses specific aspects of internationalization which are an advanced stage in Uppsala's model. According to them, a company will carry out international production if it meets the following requirements:

1. The company has ownership-specific advantages, namely certain advantages that other competing companies do not have.
2. Internalization. The main reason for companies to internalize the market is usually uncertainty, and the greater the level of uncertainty, the greater the profits for the company.
3. Location-specific advantages. It should be more profitable for a company to take advantage of its assets overseas rather than in the domestic market.

**Table 1. Stages of Internationalization by stage theory**

Johanson and Wiedersheim (1975)	<ol style="list-style-type: none"> <li>1. There are no regular import-export activities.</li> <li>2. Export through agents to neighboring countries.</li> <li>3. Have overseas sales subsidiaries and make sales to more distant countries.</li> <li>4. Producing goods abroad</li> </ol>
Bilkey and Tesar (1977)	<ol style="list-style-type: none"> <li>1. Management is not interested in export activities</li> <li>2. Management is interested in meeting an unexpected market but not actively exploring the feasibility of exporting.</li> <li>3. Management is actively exploring the feasibility of actively exporting</li> <li>4. The company exports trial and error to culturally similar countries</li> <li>5. The company has become an experienced exporter</li> <li>6. Management explores the feasibility of exporting</li> </ol>
Reid (1981)	<ol style="list-style-type: none"> <li>1. Export awareness: identify problems, opportunities, and realize that there is a need</li> <li>2. Interest in exporting: motivations, attitudes, beliefs, and expectations about exports</li> <li>3. Export trials: limited personal experience of exporting</li> <li>4. The export evaluation assesses the results of export activities</li> <li>4. Export exception: adopt or reject export</li> </ol>
Czinkota (1982)	<ol style="list-style-type: none"> <li>1. The company has absolutely no interest in exporting</li> <li>2. The company has little interest in exporting</li> <li>3. The company explores the possibility of exporting</li> <li>4. The company exports by trial and error</li> <li>5. The company becomes a small exporter</li> <li>6. The company has become a big exporter</li> </ol>
Cavusgil (1984)	<ol style="list-style-type: none"> <li>1. Marketing only sells to the local market.</li> <li>2. Pre-export: the company seeks various information and evaluates the feasibility of exporting</li> <li>3. Experimental: the company starts exporting on a limited basis to countries that are culturally close (low psychic distance)</li> <li>4. Active export: export to more new countries, direct marketing, and increase sales volume</li> <li>5. Commitment: management continuously allocates the company's limited resources for domestic and foreign markets</li> </ol>
Moini (1995)	<ol style="list-style-type: none"> <li>1. No export</li> <li>2. Getting interested in export</li> <li>3. Doing export</li> <li>4. Exports are carried out regularly</li> </ol>
Leonidou and Katsikeas (1996)	<ol style="list-style-type: none"> <li>1. Company involvement in international activities</li> <li>2. Carry out international activities by starting exports</li> <li>3. At an advanced level, the company is more intense in international activities</li> </ol>

Source: Kaukab, 2016

### 2.3 Uppsala Model

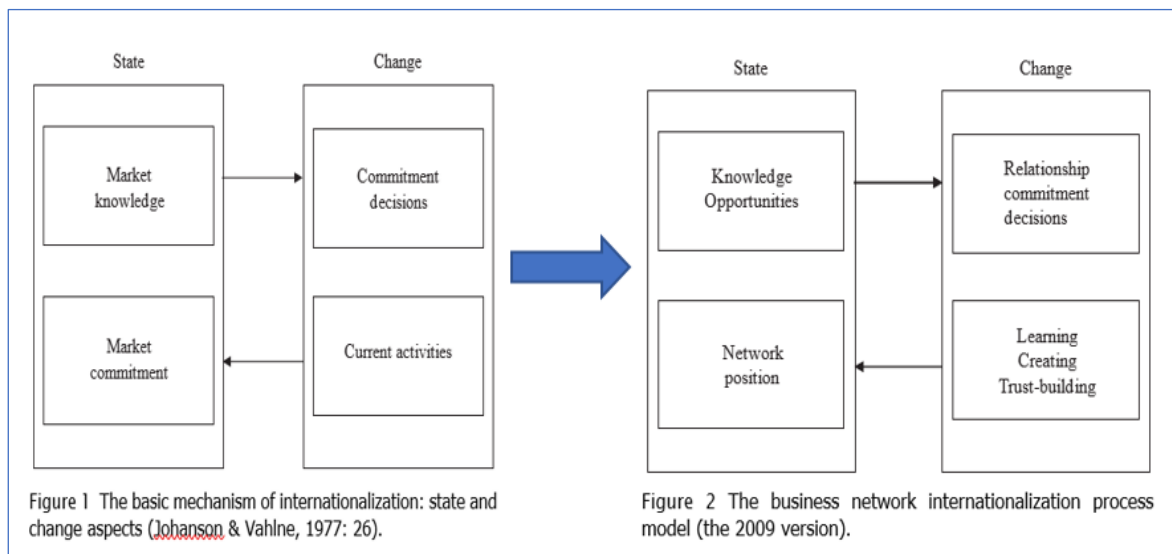
Uppsala's model has a theoretical foundation from the theory of organizational behavior and the theory of corporate development. This model views the phenomenon of company internationalization as a process in which companies gradually increase their business activities in an international scope. This model focuses on the firm as the unit of analysis and assumes that firms have rational and information limitations on international business and trade-offs between growth and risk. Steps taken to minimize these risks are translated by entering foreign markets, starting from the mode of entry with the least risk and commitment or the least cultural distance [31]. The internationalization of companies is seen as a process of increasing the international involvement of companies due to various types of learning. This model implies that firms increase their international involvement in small incremental steps in the foreign markets they currently operate. This accumulation of knowledge in carrying out global operations promotes internationalization by influencing the choice of a country's modes of entry and needs [1].

The Upsala 1977 model was later developed to describe a dynamic and cumulative learning process and build trust and commitment. The model's basic structure is the same as the one we created in 1977; the changes have added

"recognition of opportunity" to the concept of "knowledge". Other important knowledge components include the needs, capabilities, strategies, and companies' networks related directly or indirectly to an institutional context [35]. The development of the Upsala model can be seen in the image below (Fig. 1).

### 2.4 Organizational Capability Perspective

The perspective of organizational capability is based on bounded rationality. This perspective is rooted in resource-based theory [36]. The firm is viewed as a set of inactive and transferable resources transformed into enterprise capabilities through an interactive and progressive process. Individual, organizational, and technological skills are interrelated. Intangible resources such as skills and competencies consist of specific and general components. Companies that have a high ratio of embedded-to-generic know-how will tend to internalize. Market knowledge also consists of public and particular features [35]. Companies with a high ratio of embedded-to-generic market knowledge will tend to cooperate with other companies. This perspective recognizes the difficulty of the locational effect to exploit how a company is located from one country to another. Suppose the exploitation of an advantage, the potential erosion of the know-how value on the impact of the ownership effect is greater than the locational effect. In that case, the company will tend to internalize.



**Fig. 1. Upsala model concept development**

On the other hand, if the potential for erosion of the know-how value on the impact of the locational impact is greater than the ownership effect, the company will tend to choose cooperation. This perspective limits the mode of entry into two types, namely internalization and collaboration. But in practice, there are still difficulties in measuring the company's capabilities [37].

### 2.5 Network Perspective Theory

Networks are critical to international operations and enable businesses to address new and small risks [38,39]. Network theory emphasizes the intra and inter-organizational networks that are important for internationalization [40]. The business relationship is built with various alternative relationships, including: technical, social, cognitive, administrative, legal, economic, etc. In the networking perspective theory, all actors in the network play an active role, and the formation of new relationships or the development of old relationships depends on the interaction between involved parties. Connections can be used as bridges to other networks. Internationalization uses networks; from this perspective, we see the internationalization of enterprises, starting with the integration of enterprises into domestic networks. Internationalization means that companies establish business relationships overseas in three ways. First, build relationships with state networks available for business; next,

the company builds relationships with existing networks; third, relations by connecting networks with other countries [35]. Small businesses benefit from networking as they can share risk, grow globally faster, and secure property [41].

### 2.6 Concept Development

Based on the description of the theory and internationalization model above, it can be described as a comparison between several theories based on the theoretical basis, a unit of analysis, main variables, assumptions, decision criteria, and mode of the entity as follows (Table 2).

The topic of international entry-level fashion is one of the most commonly discussed topics by researchers in global marketing. There are at least two main reasons. First, the mode of entry is the main factor in the concept of internationalization. Thus, the topic of discussion on the internationalization process will cover that. Second, choosing the appropriate type of entry-level in foreign markets is an important decision for the company's internationalization. Several internationalization studies have been conducted in several countries, and the survey results show several drivers and obstacles in the internationalization process. These elements are inseparable from the type of mode of entry chosen by international companies. From several modes of entry, it can be developed into an integrated model of entry, as shown in the Fig. 2.

**Table 2. Comparison of internationalization theory and model**

	(1) Model Internasionalisasi Uppsala	(2) Transaction Cost Approach	(3) Paradigm Eclectic	(4) Organizational Capability	(5) Network Perspective
<b>Teori Dasar</b>	Resource Based Theory	Transaction Cost Theory	Transaction Cost Theory, International Trade Theory, Resource Based Theory	Resource Based Theory	Network Theory
<b>Unit Analisis</b>	Perusahaan	Transaksi	Perusahaan	Perusahaan	Perusahaan
<b>Variabel Utama</b>	Pengetahuan dan komitmen organisasi	Karakteristik Transaksi (misal: asset specificity, uncertainty frequency of transaction)	Ownership specific, location and internationalization advantage	Kemampuan perusahaan (misal: know how)	Business relationship and various ties: social, ekonomi, legal, kognitif, tektis, dll.
<b>Asumsi</b>	Bounded rationality (rasionalitas dibatasi)	Bounded rationality & opportunism	Bounded rationality & opportunism	Bounded rationality	Keinginan untuk terlibat dalam pembentukan bisnis
<b>Kriteria Keputusan</b>	Trade off antara growth dan risk	Minimalisasi biaya transaksi	Trade off antara return, risk, control, dan resources	Trade off antara value dan cost	International network member manfaat yang lebih besar daripada domestic network
<b>Mode of Entry</b>	<i>Establishment chain</i> : (1) tanpa ekspor, (2) ekspor melalui agen, (3) sales subsidiary, (4) manufacturing abroad.  <i>Psychic distance model</i> : dimulai dari pasar dengan jarak psikis (kultur) yang rendah sampai ke jarak psikis yang tinggi	Beberapa klasifikasi seperti (1) contractual arrangement, (2) Joint Venture, (3) Wholly owned subsidiary	Beberapa klasifikasi seperti (1) Independent Mode, (2) Cooperative Mode, (3) Integrated Mode	Internationalization vs Collaboration	International extension, penetration, international integration

Source: [35,31]

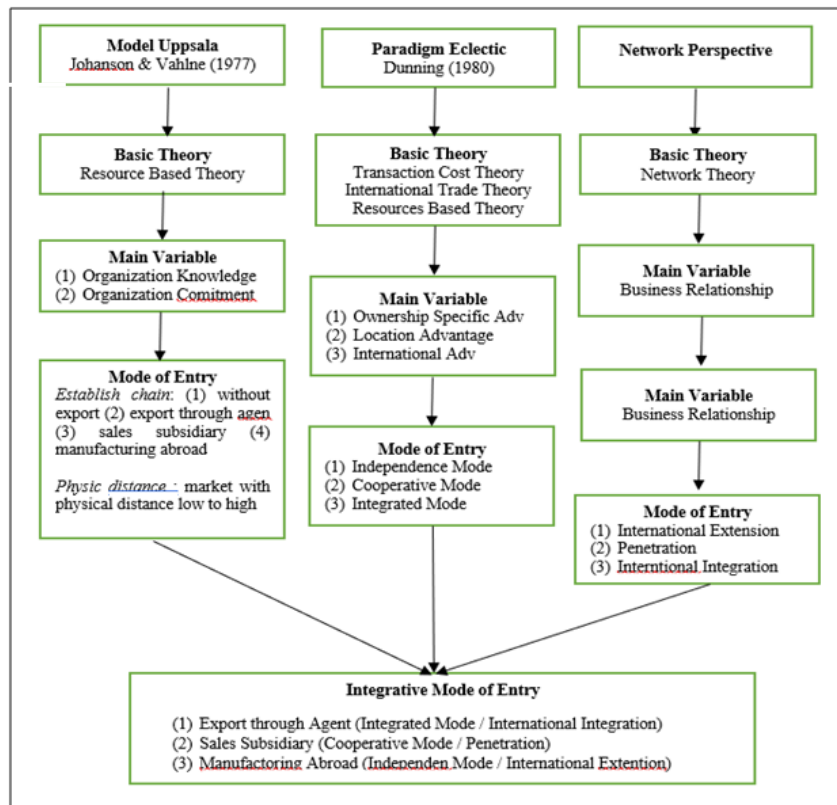


Fig. 2. Internationalization theory and mode of entry

Source: [31,42]

### 3. EMPIRICAL REVIEW

On November 15, 2020, Indonesia, China, Japan, Korea, Australia, and New Zealand discussed the Regional Comprehensive Economic Partnership (RCEP). RCEP contains a comprehensive economic partnership between these countries, and RCEP is the largest form of regional cooperation today. RCEP aims to promote regional investment and trade development and build complete, high-quality economic partnerships that contribute to global economic growth. RCEP claims to increase business opportunities and provide job opportunities. According to the Ministry of Commerce, RCEP will increase GDP by 0.05% and decrease by 0.07% between 2021 and 2032 compared to the case without RCEP.

The low performance of Indonesian SMEs in exports and competitiveness is thought to be because SMEs have various limitations in the process and implementation of innovation. This causes the resulting product to have no selling value and competitiveness with imported products with advantages, one of which is a lower price. Several resources are needed to

encourage innovation, such as capital, human resources, technology, research and development, and external factors such as marketing orientation. From the inner side of the company, these factors are, in fact, a common problem in Indonesian SMEs [43]. Study Sul-toni et al. [44] found that it was necessary to increase brand awareness and quality of SME products in Madura to make them more attractive in the international market. The limitations of SMEs in the internationalization process are also found in research by Purwanto [45]; the study results indicate that there are obstacles to the internationalization of the Magetan leathercraft business, namely complicated international trade procedures for SMEs, no overseas marketing channels, and limited resources.

The main problems in Indonesian SMEs specially in East Java include working capital and investment and difficulties in marketing, distribution, and procurement of raw materials and inputs. Other performance impacts have limited access to information regarding market opportunities and others, limitations in the field of HR expertise, technological capabilities, high transportation and energy costs, little

communication, high costs due to complex bureaucratic administration starting from obtaining business permits, and uncertainty due to policies an economy that is unclear or uncertain in its direction [44]. The relationship between innovation and organizational resources and skills is an important factor in efforts to win a competition in the global era, even in the context of Indonesian SMEs, because innovation is the key to competitive advantage [24].

Study Cahyadi [26] found that PT Heat Transfer Solutions Indonesia (PT HTSI) is a medium-sized company and is a supplier and manufacturer of heat transfer equipment based in Surabaya. The company has worked on several projects in Bangladesh and Malaysia. Local governments have a policy framework that needs to be considered because it is different from normal work habits. Work cultures are often different, and issues can take a long time to resolve. Therefore, it is important to work closely with local partners. These local partners have a better understanding of the existing business environment. Another challenge is project financing; it is very difficult to get the needed financial support due to project implementation's high cost and investment costs.

Another finding, PT Kusmajaya (PT KJ) is a medium-sized furniture manufacturer SME located in the Malang area. Since 2008, the company has focused on exports and sought growth opportunities in the growing overseas furniture market. Products are sold directly or through third parties to countries in the United States, Europe, and Asia. The furniture industry is highly competitive, and competition mainly comes from companies in China, India, and Vietnam. PT KJ's products tend to be in a higher price range than these countries, and many consumers are switching from PT KJ because the price is prioritized over quality. The cultural aspect is very important in doing business with foreign consumers. PT KJ realizes the importance of communication and the need for adequate supporting logistics infrastructure [26].

Other research conducted by Roida et al. [34] found that some SMEs did not export their products directly, but the mode of entry carried out was with the help of collectors or brokers to carry out these export activities. The role of a broker or agent has both positive and negative impacts. The positive impact is helping SMEs to internationalize, while the negative side is that collectors control all information, so SMEs act as

providers of goods, only getting orders on indirect orders from buyers. Other researcher, Anni Yudiastuti et al. [46] found that CV. Arjuna 999 is a shop domiciled in Batu City, East Java, processes various kinds of fruit chips. The owner's internationalization process occurred after going through a long process, even after being rejected several times because the product was deemed not to meet the quality requirements of similar products. Finally decided to market online through social media; at that time, he immediately received a response from a typical Indonesian souvenir business owner who is domiciled in Hong Kong. Its products have been marketed to almost all countries in ASEAN and have been expanded to the Middle East. Its main products rely on local wisdom, and currently, various crispy and frozen chips have been developed. Marketing is done through online IG; a special team manages FB, Shopee, and Content as partners; the mode of entry that is carried out is to strengthen networking through social media. SME woven bag artisans also do the same thing in Ngawi; the strategy taken to maintain networking and attract buyers from abroad is to do marketing through social media [47].

Another finding, CV. Arjuna Flora is a flower export company that started internationalization with export-import starting with Japan then expanding to Taiwan, the Netherlands, and Nepal as a Japanese network. The implementation of exports initially encountered various obstacles; according to CV Arjuna Flower, the most important export factor was maintaining commitments by the MOU, even though sometimes they had to suffer losses. This commitment provides a positive perception so that the company can continue to grow through networking from customer references. In this case, the strategy of internationalizing the mode of entry carried out by CV Arjuna 999 and CV Arjuna Flora is to develop networking [46].

The influence of networking in export activities is corroborated by research findings by (Ratnawati, [48]); networking has a direct effect on the performance of the creative industry of drum jimbe artisans, meaning that with the development of the jimbe drum creative industry network, the version of the drum jimbe SME will increase. Kendang Jimbe is an SME that exports its products to China. The role of networking that is carried out can increase production volume and reduce production costs by having a network of raw material suppliers that support production



raw materials; besides, the distribution network owned can meet the accuracy of overseas shipments.

## 4. CONCLUSION AND RECOMMENDATION

### 4.1 Conclusion

This study begins with the concept of internationalization, internationalization in SMEs in Indonesia, specially in East Java, obstacles, and strategies for achieving them. The role of SMEs has proven to be significant for the nation's development agenda because they make a sizeable contribution to economic indicators, absorb a lot of labor so that it helps the problem of unemployment and helps growth, and creates a strong financial foundation for both in the creation of new industries, as well as strengthening existing sectors. For future industrial development. Nevertheless, SMEs in East Java still have to deal with various obstacles to internationalization. The current theory explains the multiple challenges and the mode of entry strategy, which is an important aspect of the internationalization of SMEs. Empirical data shows that the process of internationalization of SMEs in Indonesia still has many challenges. Through empirical data, it is found that the most common challenges are limited knowledge of markets, trade regulations and policies, barriers to communication, financing, and transportation supporting infrastructure. The mode of entry networking strategy is the main thing that SMEs can do to independently carry out the internationalization process. This study contributes to a theoretical and practical review of the SMEs internationalization mode of entry strategy

### 4.2 Recommendation, Limitation and Future research

Based on the study results, it is hoped that policy makers will have breakthroughs to encourage, support, and facilitate the internationalization process by responding to various obstacles SMEs face. By examining some of the barriers that often occur to SMEs in East Java, the following strategies can be recommended to be applied in the process of internationalizing SMEs in Indonesia, including:

1. Efforts taken by the government in developing the SME business are through

the development of a conducive business climate. To achieve this conducive business climate, it is necessary to create a conducive policy environment for SMEs. This conducive policy can be interpreted as a transparent policy environment and does not burden SMEs financially and excessively.

2. The development of SMEs should be directed at the supply driver strategy, namely the development of market-oriented SME programs, and based on considerations of efficiency and the real needs of SMEs (market-oriented, demand-driven programs). The focus of this program is the efficient growth of SMEs, which is determined by the sustainable development of SME productivity, which in turn will encourage the sustainable growth of SMEs.
3. Facing the challenges of economic globalization and free competition, unequal structures, and access gaps are no longer relevant to be maintained. This reform is very pertinent to give SMEs open space to catch up with the right strategy. The role of the government in providing facilities and infrastructure is very important to be pursued in supporting the internationalization process to run well.
4. The establishment of strategic alliances between SMEs and foreign businesses is the most important and effective mechanism for business information, technology, managerial and organizational capabilities, and access to export markets for SMEs. In this alliance, SMEs or foreign businesses or domestic businesses cooperate based on mutual will and interests, so the networking process becomes an important thing to do as one of the modes of entry for the internationalization of SMEs in East Java.

Empirical review in this paper limited based on the internationalization of SMEs in East Java. In future research it will be interesting if there is more empirical evidence from all over Indonesia so that it can provide a deeper understanding of the internationalization strategy of SMEs in Indonesia and more broadly for decision making for the government.

### COMPETING INTERESTS

Authors have declared that no competing interests exist.

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