WHITEPAPER

INTERNATIONALIZATION OF SMALL AND MEDIUM-SIZED ENTERPRISES
**ABSTRACT**

*This whitepaper discusses the internationalization of small and medium-sized enterprises. Furthermore it contains subjects like internationalization of SMEs in the time of globalization, reasons for internationalization, SMEs’ motives for internationalization, different forms and models of SMEs internationalization and dealing with internationalization by SMEs.*

**INTERNATIONALIZATION OF SMES IN THE TIME OF GLOBALIZATION**

In the last few years the scene of global business and European market enhanced international competition in enterprises concentrated on export and as well as in those concentrated on domestic markets. Traditionally export was the way of making individual companies more present worldwide. It has been seen as a traditional way to internationalize. It is still very important but during a couple of years’ process internationalization started to become more complicated and other factors are also necessary to achieve competitiveness by the company.

Foreign partnerships, foreign investments and cross border clustering represent viable ways to facilitate exchanges of knowledge and technology and to strengthen international business strategies of SMEs. Such international activities cover both outward (e.g. sales/export) and inward (e.g. import or access to knowledge) activities along the value chain. Exporting firms are also often involved in a range of inward and related activities that interact with each other.

Furthermore, there is evidence that the presence in the foreign outlet markets and the possibility to delocalize parts of the value chain allow SMEs to achieve more solidity and durability in production and, in general, in all their economic activities compared with other SMEs that develop a strategy which is purely based on exporting.

Plenty of SMEs in all industries face incredible fast growth of competition because of internationalization. Nowadays they have to think about the strategies helping them to face the challenges which are waiting for them. SMEs which want to be more competitive and which think about internationalization, have to pay attention on global differences between production conditions in different countries (e.g. labour costs), and have also to think about the ability to develop and absorb new technology. They have to have knowledge about the new markets on which they want to exist, as well as they need to have an idea about the access to capital. Because of this many factors which companies have to deal with, internationalization is one of the most complicated processes that any firm can undertake.

**INTERNATIONALIZATION REASONS**

The main reason for SMEs to act on a global scale is the ambition to improve the competitiveness of the enterprise based on economic parameters such as: market size and costs.

From this point of view, internationalization is closely linked to a value chain perspective: maximizing returns and minimizing costs in purchasing, production and sales. Some enterprises do not think about competitiveness, but they want to improve their innovative capability, to introduce new products or services to the market. Some companies may also seek to obtain access to larger markets more indirectly via strategic collaboration.

Thinking about the internationalization process of SMEs is also connected with thinking about the current experience and knowledge of the firm, together with current commitments and activities. Commitment decisions are influenced by the firm’s opportunity horizon, as well as economic and uncertainty effects. It is assumed that decisions regarding international market opportunities are dependent on, and formed by, the firm’s experience. The firms therefore addresses market
opportunities in the environment with which it interacts. It is this environment that constitutes the firm’s opportunity horizon.

SMES’ MOTIVES FOR INTERNATIONALIZATION

There are several motives for internationalization which have also great influence on the way of internationalization by the SMEs:

Figure 1: Motives for internationalization

As we can easily notice, access to new and larger markets is the main reason for internationalization by SMEs that export or have establishments abroad. For SMEs that have only imports, this access is not a more frequent motive than access to know-how and technology, or high production costs on the domestic market. This means that the decision to actively go abroad does not simply arise as a subsequent stage to having a foreign supplier, but rather the different internationalization types are related to different strategic aims.

DOUBTS ABOUT INTERNATIONALIZATION

Thinking about internationalization of SMEs we have to ask why not all of them want to act worldwide. Why do not all of them tend to be international? Why do they abstain from internationalization processes?

There are two main reasons why there are still SMEs which are non-international. First of all, for some of the enterprises external barriers are too high. Secondly, some of the companies do not even think about being international. Those who are not thinking about internationalization process do not think about the barriers. They just think that internationalization processes are not necessary and the domestic market is enough for them. Sometimes they just do not have the ambition to grow to larger size and to go beyond the domestic market. They think that the domestic market is large
for them now and it will be big enough in the future. Possibly they have doubts connected to external dependence or loss of control.

DIFFERENT FORMS AND MODELS OF SMES INTERNATIONALIZATION

It is becoming increasingly difficult, if not practically impossible, for independent small firms to thrive by taking refuge in their traditionally protected markets. That is why nowadays SMEs are taking advantage of globalization processes and they want to be more independent form domestic market.

As was mentioned before, internationalization is not only export, but a process which has many business activities inside. These are: cross-border collaboration, cross-border clustering, alliances and subsidiaries, branches and joint ventures. We have to investigate how SMEs with different types of international activities also in different size and from different sectors remove barriers and achieve international level. That is why we have to divide SMEs in three groups, according to different internationalization profiles and representing different strategic approaches to internationalization:

- Foreign supplier as the only form of internationalization,
- Export as only form of internationalization,
- Branches, joint ventures and combinations of them as one way of internationalization.

A DIFFERENTIATED INTERNATIONALIZATION PROFILES OF SMES

<table>
<thead>
<tr>
<th>Percentage of total SMEs:</th>
<th>Percentage of total SMEs Type of internationalization:</th>
</tr>
</thead>
<tbody>
<tr>
<td>30%</td>
<td>foreign supplier (import only),</td>
</tr>
<tr>
<td>18%</td>
<td>exporting only,</td>
</tr>
<tr>
<td>3%</td>
<td>collaboration, primarily with foreign SMEs,</td>
</tr>
<tr>
<td>3%</td>
<td>branches, subsidiary, join venture abroad.</td>
</tr>
</tbody>
</table>

Note: The above percentages cannot be summed, since individual companies may figure in several categories.

The prevalence of different forms of internationalization among SMEs:

18%  - foreign supplier only form
6%   - export only form
13%  - subsidiary abroad or more than 1 form of internationalization
63%  - non-internationalized

Of all SMEs, 18% use only import, without exporting or having foreign establishments. Another 12% have imports in combination with export or foreign subsidiaries. Hence, of the 13% in the group engaging in more complex forms of internationalization, almost all have a foreign supplier. An interesting finding is that exports seem to be much more frequently combined with a foreign supplier than as an isolated activity. Only 6% have just exports, but 10% of SMEs have both foreign suppliers and exports. This might indicate that having a foreign supplier somehow supports or promotes export-related activities.

INTERNATIONALIZATION OF SMES BASED ON COUNTRY SIZE
Generally small countries compared to bigger ones are much more internationalized. Let us concentrate on the EU:

![Diagram showing percentage of SMEs with foreign suppliers or exports in different countries.](image)

Figure 2: Percentage of SMEs with foreign supplier or exports

The tendency is very clear. SMEs in small countries more often have foreign suppliers than the SMEs in larger countries. A high share of SMEs with foreign suppliers does not mean a high share of exporting SMEs.

**INTERNATIONALIZATION IN STAGES TOWARDS AND COMPREHENSIVE VIEW**

We have to check whether different types of internationalization represent strategic choices by SMEs that differ in their structure, activity and functioning, or whether they represent different stages of a process. A prevailing model of the internationalization process is the Stage Theory, according to which internationalization takes place in progressive stages, moving from low commitment/risk to high commitment/risk.

The rationale behind this model is that a progressive strategy minimizes the risks and investment amounts required at one point in time. Typically, enterprises start by exporting to markets within little geographic distance. Once they have gained experience from these initial export activities, they then expand their export activities to more distant markets. Other studies also find evidence against the Stage Theory concluding that more than 40% of internationalized SMEs follow a discontinuous development pattern inconsistent with the Stage Theory.
In the internationalization process SME’s have to deal with a variety of or new processes and factors with which they did not have to deal with while being a company which activities concerned only their domestic market. These elements can hold both advantages and disadvantages. Therefore, these should all be carefully considered.

PLANNING THE INTERNATIONALIZATION PROCESS

One frequent problem regarding internationalization of SMEs is the lack of an explicit strategy in the initial phases. Another problem is the lack of know-how with respect to international activities, identifying appropriate partners or estimating market potential. These are also some problems connected with management, mostly with the chief executive officer. Most of the SMEs which think about internationalization say that analysis of the foreign market potential are very important. This is as important as the predominance of sales related motives for international activities. Furthermore, many SMEs also attach high importance to analyses of the competitive and legal environment. They also know the importance of communication with the employees and other stakeholders when it comes to strategy and planning. Comprehensive and honest communication is a key to successful internationalization processes.

INTERNAL AND EXTERNAL BARRIERS

Talking about barriers, SMEs take the costs of the internationalization process as the highest one. These costs may include market analyses abroad, purchasing legal consulting services, translation of documents, adaptation of products to foreign markets, travel expenses, not to mention higher business and financial risks.

In general, SMEs with only imports see fewer internal barriers than SMEs with more outward international activities. For instance the barrier of not having enough skilled or lack of competence staff happens more often for exporters than for importers and more often for SMEs with subsidiaries than for exporting SMEs. It shows that, the more complex the internationalization activities are undertaken the more internal barriers are generally perceived by the SME.

However, it is worth noting that more than 30% of the internationalized SMEs perceive no internal barriers for the internationalization process at all. Furthermore, 59% of the non-internationalized SMEs have never considered internationalization. For these SMEs it seems that internal barriers are not so much a hindrance to internationalization as the mindset or lack of motivation or experience of the management.

Perhaps the most interesting feature is that almost a third of the internationalized enterprises have no external barriers, but SMEs with foreign suppliers are most likely to see no barriers at all. Moreover, when considering the other categories or barriers it seems that the more complex the international activities undertaken by the SME are, the more often they see barriers. This indicates that barriers are usually discovered when the different types of international activities are developed.

Lack of support and advice and lack of information are no common barriers. This may reflect the widespread existence of policy measures directed towards informing and supporting internationalizing enterprises. About 20% of the internationalized SMEs perceive lack of support and advice, and about 15% perceive lack of information as an external barrier. The most cited external barrier, however, is the existing laws and regulations of the target countries. Last but not least, we must not forget shortages of capital or trade barriers.
INTERNAL COMPETENCIES

Engaging in international activities needs extra competencies compared to strictly domestic activities. The competencies needed typically encompass not only a different working language connected with cross-border relations, but also knowledge about the foreign market conditions, laws and regulations or cultural difference. These competencies can be developed in a learning-by-doing process or by employing experts. However, the amount of international experience of the management is very important.

Several studies find out that the international experience of the founder(s) or manager(s) of a company increases the speed of foreign market entries. For that reason, some SMEs may internationalize earlier than others. Some firms have a top management team with previous international experience and they are willing and able to pursue new combinations of key resources across national borders early on in the firm’s existence. Other companies do not have such opportunities and the process of their internationalization will start on a quite late state of the company’s life. Very often managers with extensive foreign experience are found much more frequently in exporting SMEs, than in non-internationalized SMEs. This is evidence that managers with prior international experience drive SMEs into international business more successfully than other managers, or that SMEs with international aspirations tend to employ managers with international experience.

COMPETITIVENESS AS A RESULT OF INTERNATIONALIZATION

International activities may have some effects on sales but they may also affect the firm’s competitiveness in general or in specific areas, which are hard to measure. The enterprise may for instance improve its cost-efficiency by outsourcing abroad or it may develop its know-how and technology competencies by collaboration with clients and suppliers in other countries.

However, engaging in international activities could also have more positive impacts on the competitiveness of the SME. Starting trade or cooperation with partners in other countries possibly offer new challenges and opportunities to the employees, or improve the SMEs’ scope of recruitment and their ability to keep highly skilled employees that often focus on career and personal development.

A recent Italian study gives a possible reason for the better performance, on average, of those firms with more complex forms of internationalization. On the basis of data from 220 Italian SMEs, the performance seems related to the ability of the firm to gain access to the North American market. Similarly, the ENSR Enterprise Survey indicates that SMEs that have complex international activities in the US perform better than those SMEs with only a foreign supplier or exports to the US. Both the ENSR Enterprise Survey and the Italian study thus indicate that the challenges of entering the American market successfully push SMEs to develop competencies that eventually lead to better overall performance. A German survey of 633 enterprises concludes that the competitiveness of enterprises increases considerably with the degree to which they have business contacts and sales offices/production sites in other countries.

Moreover, enterprises with a high export share have a much higher valuation of their competitive strength than enterprises with lower export activities. The German survey thus supports the findings of the ENSR Enterprise Survey 2003, that increased internationalization will strengthen the competitive position of the enterprise. A Spanish study using data on SMEs’ financial performance confirms that internationalized SMEs perform better than non-internationalized SMEs. A Finnish study of 200 industrial SMEs indicates that internationalization seems to have positive effects in particular on manufacturing, marketing and acquisitions of companies. The Greek manufacturer of
men's underwear, Apple Boxer S.A. is an interesting case in showing that internationalization is risky, but that it may nonetheless help to improve competitiveness in the domestic market.

CONCLUSION

There is lots of theoretical information about internationalization of small and medium-sized enterprises, however, it is interesting to note that the majority of studies regarding to internationalization have focused on the activities of large organizations. But there is no question from the findings of this paper that small companies have the potential and capability to enter international markets. However, what is important in terms of contribution to theory development is how the company manages to overcome the obstacles in the international development process and successfully establish a presence in foreign markets. The main barriers to internationalization are financial commitment, complexity of international markets, lack of market information, and brand control and management resources issues. In reality, we may argue that networking resources could overcome these obstacles whereas also the use of government and consultancy services may help gaining market information for SMEs.

SOURCE

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