Internationalization of Small and Medium Sized Enterprises

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Abstract
Small and midcap Enterprises (SME) are the most important part of Germany’s economy:
• 99.3 % of all German companies
• 3.55 million SME in Germany
• Employing more than 24.3 million people
• Generating more than 60 % of Germany’s turnovers
But Germany’s SMEs are reluctant to go abroad. This paper intends to fill gaps in knowledge on German SME internationalization and explore the cause and effect chain of SME characteristics, SME internationalization modalities and internationalization success in more detail.
• To what extent do SME characteristics (e.g. firm age, branch, size, leadership) determine internationalization preparation, strategy and possible impediments to internationalization?
• To what extent do parameters of internationalization preparation, strategy and possible impediments to internationalization determine the degree of SME internationalization success and performance?
• To what extent does the degree of SME internationalization determine SMEs’ competitive performance?

To answer these research questions the paper conducts a systematic review of previous studies on SME internationalization strategies, impediments and success and derives categories to assess the cause and effect relationships of SME internationalization systematically.

Keywords: Internationalization, leadership, management, SME, strategy

JEL Classification: F23, L10, M10, M13

1. Introduction
SMEs are an integral part of Germany’s economy. 99.3 % of German companies are SMEs. These 3.55 million German SMEs employ more than 24.3 million people and account for more than 60 % of Germany’s turnovers. According to an EU definition SMEs comprise three firm size categories:
• Micro-enterprises: < 10 employees; turnover or balance sum < 2 million Euros p.a.
• Small-enterprises: < 50 employee; turnovers or balance sum < 10 million Euros p.a.
• Medium-sized-enterprises: < 250 employees; turnovers < 50 million Euros or a balance sum < 43 million Euro (KfW, 2012). These firms are in the focus of this research paper.

Mugler (2005, 31-32) additionally suggests qualitative characteristics to differentiate SMEs from large corporations: SMEs are specialized in individual products and services on customer demand. Relationships between employees and management frequently are informal and personal, which results in a low degree of formalism and bureaucracy and enables SMEs to react to environmental changes rapidly.

In spite of these virtues on a local level only 25% of Germany’s SMEs operate internationally (Geyer & Uriep, 2012, 1). Only 16 % of SME turnover is from exports. In total German industry though earns more than 30 % from export goods (Yalcin & Zacher, 2011, 17).
Why are Germany’s SMEs reluctant to go abroad?

This paper intends to fill gaps in knowledge on German SME internationalization and explore the cause and effect chain of SME characteristics, SME internationalization modalities and internationalization success in more detail.

It asks the following research questions:

- To what extent do SME characteristics (e.g. firm age, branch, size, leadership) determine internationalization preparation, strategy and possible impediments to internationalization?
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2. Motivations of SME internationalization

Internationalization promises to support the primary entrepreneurial objective of expansion and profit growth by essentially four motivating categories: Political and economic deregulation, decreasing cultural distance and advancements of information and communication technology reduce perceived entry barriers to international markets. Expanding and diversifying the supply chain to foreign countries promises cost savings, concerning labour material and financial expenses. Decentralization is expected to diminish transaction costs. Internationalization opens up new sales markets: New customer groups are interested in novel product variants. Changing production technologies and competitors moves partly make international expansion unavoidable to remain competitive. Participation in international markets strengthens knowledge development. International SMEs find qualified staff more easily, learn from foreign partners and develop international market experience and advance intercultural development.

3. Forms of going international

Depending on the individual target system firms will chose forms of internationalization. The conception of internationalization forms is linked to the definition of the term of internationalization itself. Ruzzier (2006, 479) contrasts several definitions of internationalization and argues that some definitions focus on the perspective of the expanding firm, differentiating the process of expansion and firms’ strategic set up, whole others find the idea of networking and cooperation crucial.

Figure 1: Forms of international expansion (own draft on Meckl, Weusthoff, 2008)
Forms of internationalization are equally diverse as these definitions: International growth can rely on the self-reliant expansion of the mother company – which comprises the inner growth of the mother firm and the foundation of a legally independent daughter company.

4. Process patterns of SME internationalization

Summarizing the empirical insights on internationalization strategies of SMEs, the categories traditional (in the sense of the Uppsala model), “born-global” and “born-again global” are typical internationalization strategies of SMEs. The following overview summarizes SME characteristics that encourage these approaches:

Figure 2: SME patterns of internationalization (own draft)

5. Impediments and risks of SME internationalization

Existing empirical studies evaluate impediments to SME internationalization to extent. Across the studies essentially eight fundamental issues have been identified, which are detailed in the following:

Figure 3: Overview on impediments of SME internationalization according to the review (own draft)
6. Material and Methodology

To answer these research questions the paper conducts a systematic review of previous studies on SME internationalization strategies, impediments and success and derives categories to assess the cause and effect relationships of SME internationalization systematically.

The initial research questions concretize in the following hypotheses:

Figure 4: Comprehensive research model (own draft)

Firm characteristics determine
H1) preparation to internationalization by value added stage,
H2) internationalization strategy
H3) experienced impediments to internationalization.

Preparation to internationalization by value added stage determines:
H4) growth-related industrialization success
H5) performance-related industrialization success

Internationalization strategy determines
H6) growth-related industrialization success,
H7) performance-related industrialization success

Experienced impediments to internationalization determine
H8) growth-related industrialization success,
H9) performance-related industrialization success
H10) Growth related industrialization success positively determines performance-related industrialization success

These hypotheses concretize in the following work model that interlinks three levels of consideration: firm characteristics, internationalization modes and internationalization performance.
6.1 Data of the questionnaire

The questionnaire is structured according to the categories of the work model. Originally it is drafted in German but translated for the purpose of this paper. To assess firm characteristics it asks: the firm age, the business, the firm size and the leadership quality. About 300 firms were contacted - 184 participated - 167 valid questionnaires could be used.

To assess the preparation of the firm to internationalization by value added stage the survey contains several questions to Marketing, R&D, Production, Sales, Acquisitions, Staff management, corporate finance, IT support. Answers are scaled on a Likert scale from 1 = low, 2 sufficient, 3 good, 4= very good.

To assess internationalization strategy participants’ personal estimate of the strategic quality of the following 38 fields is estimated employing the same 4 grade Likert scale: cultural integration, communication & networking, strategic planning skill and staff/knowledge management beforehand. Obstacles to internationalization (O1 to O 5) are each assessed in one part question, which are: „Which factors in your opinion impede internationalization in your firm?” Answers are again ranked on the described 4 grad Likert scale. The following factors are for choice:

Lack of: Capital, leadership competence, strategic and organization, knowledge management functional departments and operative staff, language and culture experience in international project management.

To determine internationalization success the categories growth-related and performance-related internationalization success are examined.

7. Selected Summary of results

The results of the survey now are brought together in a comprehensive model of SME internationalization:

The model displays that inter-nationalization success results from a contingent interaction of firm characteristics, entrepreneurial internationalization strategy and external and internal opportunities and impediments.

Firm characteristics are crucial to preparation to internationalization at different stages of the value added chain as well as to internationalization strategy and determine perceived impediments to internationalization.
The survey finds that leadership quality is the by far most important driving factor for all three relationships. Previous research differentiates three different strategies of internationalization - the traditional gradual approach according to the Uppsala model, the born global and reborn global strategy (Olenik, Swoboda, 2012, 491; Lehmann, Schlange, 2004, 2010; Moen, Endresen, 2004, 1237). Each of these strategies can be successful but success or failure to a large extent depends on management attitude and skill.

The share of international turnovers increases when preparation of IT support, sales and corporate finance are given particular attention. The share of international purchasing depends on R&D, sales and purchasing preparation. On the other hand firms with deficits in IT support and production preparation frequently are in quest of further new markets, possibly to compensate for difficulties in the home country or other previous target countries.

According to the survey a solid internationalization strategy based on cultural integration, intense communication and networking, profound staff & knowledge management as well as in depth strategic planning only partly explains internationalization success. Possibly a high degree of internationalization goes along with increased production and sales in the target country rather than with a growing import business. On the other hand the share of international turnovers can be augmented by solid internationalization strategies.

Competitive performance as a whole though is not correlated to internationalization strategy at all. For the firms of this sample competitive positioning does not depend on the degree of internationalization hence. Firms disposing of a solid internationalization strategy according to the survey usually are not searching for new markets eagerly (significant negative correlation). Possibly they are satisfied with their established international engagements; possibly they have been disappointed abroad. Observations on the success impacts of perceived impediments to internationalization seem to support this final assumption:
According to the evaluation of H8 leadership and capital deficits load positively on the share of international turnovers and acquisitions. Participants complaining about lacking capital and lacking leadership competence simultaneously observe high shares of international turnovers and acquisitions. The fact that SMEs with high foreign engagement lack capital and dispose of low leadership competence suggests that survey participants are little enthusiastic about their firms foreign engagements, see the financial risks and assign deficits to leaders’ decision-making.

8. Recommendations

Which development options for SMEs exist given these results? As detailed in the preface German SMEs still are reluctant to go international (Geyer, Uriep, 2012, Yalcin, Zacher, 2011, 17) and most SMEs are coined by the personality of a single firm leader (Mugler, 2005, 31-32). The present study has identified leadership quality as core and crucial competence for preparation to internationalization and the development of a solid internationalization strategy. Even perceived impediments to internationalization to a large extent depend on firm leaders’ attitude. These findings on the one hand support Mugler’s (2005, 31-32) observation. On the other hand they lead the way to a solution of the difficulties German SMEs face in the internationalization process.

In practice this means: SME leaders with little international experience intending to start an international venture should from the beginning seek expert advice and admit internationally experienced managers and consultants to their management team. Successful internationalization is much about local cultural knowledge and business experience, which small and medium sized firms, that so far have served local markets only, do not dispose of. Internationally experienced advisors can help to improve the preparation to internationalization by value added stage, contribute to the development of internationalization strategies based on the development of cultural competence, efficient staff management and foreign market knowledge.

9. Theoretical and practical addition of the paper

From an academic perspective this study has for the first time comprehensively elaborated the topic of SME internationalization. Filling the model with empirical data the study has contributed to close the research gaps identified in the course of the review. This is of academic and practical relevance:

This study compares the impact of firm characteristics for eight value added stages and finds, that in R&D, sales and acquisitions, IT support and corporate finance firm characteristics are highly significant indicators of internationalization preparation, while in marketing and production firm characteristics are not significant at all. Firm characteristics are highly relevant to strategic planning skill as well as staff and knowledge management and information systems strategy, but say little on the extent of cultural integration and the efficiency of communication and networking done in the internationalization process (compare table 18).

The high relevance of leadership to internationalization success found here corresponds to previous studies (Bördin & Längner, 2012; Cerrato, 2007, Chetty, 2010; Cruz-Carreon, 2007; Meyer, 2002). This survey though considers internationalization success in a more differentiate way. Here a) performance success measured i.e. the share of international turnovers and purchasing and b) growth related success, i.e. the perceived competitive performance and desire to expand into new markets further, are analysed separately.
Important practical insights are derived from this innovative double success measurement approach:

- A sustainable internationalization strategy and diligent preparation to the venture strengthen success in existing projects, but render firms more sceptical as to new projects and further growth.
- Perceived impediments to internationalization enhance internationalization success in existing projects. That is, difficulties should be reflected and discussed openly to enhance venture success. This process simultaneously encourages a critical perspective on planned ventures.
- In sum the study points out a critical view: achieved internationalization success does not always motivate further growth but partly disillusions SMEs on initial expectations. Experience puts internationalization opportunities in a more realistic perspective.

10. Outlook: Limitations and further research needs

Certainly further empirical research drawing on larger SME sample and differentiating by SMEs types will be necessary to develop reliable insights on the whole complexity of determinants of SME internationalization success. The regression models derived in this paper each dispose of very limited explanatory power (small $R^2$ values). Partly remaining cross-correlations among the residuals suggest that a broad range of further issues exist that determine SME internationalization performance and growth intentions. Probably a structural equation model would have been better apt to evaluate the relationships between the broad range of input factors and outputs in more detail.

Nonetheless the study has found that the observed sample of German SMEs to date is not really satisfied on the success of their international ventures. Leadership quality determines SME internationalization strategy and success to a large extent. SMEs could enhance their international competence and success by trusting on the advice of an internationally experienced management team or specialized external consultants.

References