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What challenges does internationalization pose for small and medium-sized enterprises?
Small and medium-sized companies are used to operate in their local market. They know their customers’ habits and needs and they try to bring products and services that suit them. But SMEs need to grow and develop their activity in order to remain competitive and to increase their market share. For that purpose, a SME can expand its activity to a regional or a national area, but very often competitors are already well settled and it is not so easy to conquer their market shares.

The importance of SMEs

The SMEs take a very huge part in the world economy: 60 to 70 per cent of the employment in the world is in SMEs (OECD). About 25 per cent of manufacturing SMEs in the OECD countries are now internationally competitive, and SMEs contribute between 25 per cent and 35 per cent of world manufactured exports (Szabó, 2002). Most of the SMEs are in the service sector, but their activities differ depending on whether they are located in a developed country or in a developing state.

In developed economies, SMEs specialise in niche markets or become supply partners for large companies, whereas in developing economies, SME tend to compete with large companies in the same market, but many of them fail.

Why to internationalize?

The economic world changed very quickly in the last decades. The creation of common or open markets, the increasing foreign investment, the increasing mobility of capital, technology and management (OECD, 1995) have created great opportunities for SMEs to internationalize and, by the way, to extend their activity and their value chain across borders.

But a SME has many challenges to face in order to become a global SME. This essay tends to show these challenges at the different stages of the internationalisation process: first, the issues to face before becoming an international SME (that is to say how to get prepared for
internationalization); and second, the challenges to get internationalized (making choices about the way the SME is going to internationalize its activity).

**Internal challenges and preparation of the SME for its internationalisation**

Before going international, the SME has to prepare itself by making the right decision, analysing its internal situation (in terms of products, production, competences and financial resources), and analyse the new market that the company wants to reach. These are the first challenges before thinking about the way the company will become global.

According to a research led by Brahim Allali (University of Montréal, Canada, 2002), the managers who internationalize their SME on a reactive basis, i.e. in reaction to an internal or external stimulus, “tend to follow a step-by-step process in the internationalization and are more inclined to reassess the decision of internationalization when the first performances carried out abroad do not give them satisfaction”. On the other hand, the managers who make this decision on a proactive basis tend to engage their company on the international markets in a more active and a more durable way.

After the manager decided to internationalize his business, he has to choose a first foreign market. The analysis of the foreign markets must take account of 4 essential factors: the sales forecast, the production for the market and its generated costs, the receptivity of the market, and its stability. From the elements highlighted in the analysis, the enterprise will work out a strategic plan to establish its products in the foreign markets. This goes by an adapted marketing mix around three axes: the target (the segments on which the SME wants to operate), the positioning that it wants to hold, and the means it has to implement.

The SME will also choose the foreign market according to the importance of its communication networks, and the perceived risks of international trade in the foreign country (Johnson and Turner, 2003). This includes commercial risks, such as the insolvency of the buyer or the risk of non-acceptance, and political risks, like the cancellation of the export or import licence of the company, war risks, risk of expropriation or confiscation of the company, etc.
But most of the times, it seems that the decision of the foreign market choice is made by the manager in regard to its personal point of view. Nevertheless, he should take account of the above analysis and act in a realistic and reflective way.

After having taken the decision of investing foreign markets, the enterprise has to make an audit of this new country and this new market and then, an internal audit to examine what the SME will have to do to get ready for internationalization.

The audit of the foreign market begins with macro-environmental issues. This includes questions related to geography, economy, politics, culture, transports, communications and business practices. The SME should analyse the principal economic regions of the country, the size of its market, its geographical accessibility, the industries implanted in the country, the commercial restrictions, the cultural compatibility, and the legal and political situation (tax policy, employment laws, environmental regulations, trade restrictions and tariffs, political stability).

The SME can now analyse the demand and the competitors. To evaluate up to what point the products can satisfy the needs for consumers but also distributors, the adequacy between the product and the market must be analyzed in a quantitative and qualitative way. From the quantitative point of view, the company will have to quantify the number of real or potential purchasers, the average quantities bought by each customer, and the turnover and market share forecast. From the qualitative point of view, the SME must determine the market segments it is going to target and measure how much its products bring a satisfaction to the identified needs. This analysis should enable the company to adapt its offer for this particular market. This point will be developed afterwards in this essay.

Facing the competition, the company must determine its position towards the market and each segment. It can use two relevant tools to evaluate it. First, The BCG growth-share matrix displays the various products on a graph of the market growth rate versus market share relative to competitors. The company should use it to position its products in the foreign market. Second, the SME should use the Porter’s five forces method (Michael Porter, «Choix stratégiques et concurrence», Paris Economica, 1982); the business manager seeking to develop an edge over rival firms can use this model to better understand the industry context in which the firm will operate in the foreign country. This includes suppliers’ power,
buyers’ power, barriers to entry, threats of substitutes, and clearly the degree of rivalry. In pursuing an advantage over its rivals, a firm can choose from several competitive moves: **changing prices to gain a temporary advantage, improving product differentiation, or exploiting relationships with suppliers.**

From the analysis of the foreign market, the SME will extract relevant points, like the needs of its future customers, the standards that the product has to meet, the competitor products in the foreign country, etc. It will then be able to implement an **internal diagnosis** relative to all the issues of the external audit.

The first challenge in the internal audit is to know whether the SME has to adapt its product to the new market, and overall, **how to adapt.** For example, according to the U.S. Department of Commerce, to enter a foreign market successfully, a U.S. company may have to modify its product to conform to government regulations, geographic and climatic conditions, buyer preferences, or standards of living. The company may also need to modify its product to facilitate shipment or to compensate for possible differences in engineering and design standards (Woznick, 1998). But **market potential must be large enough to justify the direct and indirect costs involved in product adaptation.** The firm should assess the costs to be incurred and even if it may be difficult, determine the increased revenues expected from adaptation. The decision to adapt a product is based partly on the degree of commitment to the specific foreign market; “a firm with short-term goals will probably have a different perspective than a firm with long-term goals”.

The production tools also must be adapted. The SME must have a sufficient production capacity to satisfy both its domestic market and the foreign one. Stocks will increase, so the company should have good competences in terms of logistics. Moreover, the staff should be prepared for the internationalization: should it acquire new competences?

All these adaptations imply a cost. The **financial issue** is maybe the main challenge in the internationalization process of a SME. SMEs are heavily reliant on bank loans and the financial means of their owners, which are often limited. In addition, Hauser (2000) notices that although smaller companies tend to have a higher turnover yield, larger firms are in a better position to cover temporary losses. They normally have much higher financial and non-operational incomes and a better equity capitalization. In the result, SMEs tend to have more
difficulties to finance investments or R&D projects. Therefore the SME has to focus on its financial resources and examine carefully its situation before internationalizing its activity.

Challenges to face to get internationalised

Once the market has been analysed and the audit of the company has been done, another challenge for the SME is to choose how it will develop in the international context. The concept of internationalization has evolved in the last two decades. At the beginning the internationalization processes took place mainly through export-imports and foreign direct investments. Today, there are more ways to interact in foreign markets. The different theories about internationalization analyses the choosing among the various ways on which the firm can execute international activities, summarised in direct investments, export activities, concession of licenses on manufacturing goods or franchising services. International strategies differentiate between exportation, licensing, joint venture and the establishment of foreign subsidiaries. Of these activities exportation is the most common. Zhan Su and Raymond Poisson describe the process of internationalization based on the analyses of 39 small and medium sized high-tech Quebec companies. The authors highlight that “the majority of our sample enterprises have experienced an evolution in line with the Internationalization Stages theory, they equally use many other types of inter-enterprise accords. These more flexible methods insert themselves between the more "popular strategies" within the Internationalization Stages theory. It is plausible to believe that the utilization of accords, as well as alleviating the problem of constraints on resources, which is a frequent problem among SMEs, opens the path towards the adoption of more important strategies as the enterprises commits itself more and more in the foreign market.”

The Internationalization Stages theory that the authors mentioned had been developed around the works of Johanson and Vahlne, who created the Uppsala Internationalization Model. It shows a theoretical process by which a company goes by to internationalize its activity: no regular exportations, then exportation by independent representatives, then establishment of foreign sales affiliates, finally the installation of foreign production facilities. At each step the international engagement degree increases. Small firms, however, cannot enjoy all the options in the internationalization process outlined in the literature (Baird, Lyles, and Orris 1994). “For example, small firms located in southern Italy are known to have a structural handicap in the form of limited financial resources. It is
therefore unrealistic to expect them to follow an international development path based on direct foreign investment or to take other initiatives requiring substantial capital.” It has also been shown that under certain circumstances, an entrepreneurial culture resistant to change, an increasingly centralized behaviour and other country specific factors can hinder the international development of small firms (Minguzzi and Passaro 1997, 2001). Consequently, among small firms located in southern Italy, export is still the most widespread form of internationalization.

In Europe, the SME can profit from similar life-styles in different countries, so they do not have to bring many adaptations to their product. VanderMerwe and L’Huillier forecast the emergence of six clusters of ‘Euro-consumers’ based on geographic proximity as well as cultural, demographic and economic factors. According to their research, the Euro-market is reasonably homogeneous in those six major ‘clusters’ having similar demographic and economic characteristics that cut across cultural and national boundaries. They suggest that even small companies can compete effectively in the new Europe by accurately targeting the needs of narrow multi-country segments. These geographical clusters are: the UK and Ireland; France and Switzerland, Spain and Portugal, North Italy and Austria, South Italy and Greece, West Germany, Luxembourg, the Netherlands and Denmark. Managers working in those markets should be able to reach larger cross-cultural Euro-consumers’ groups without marketing separately. The clusters indicate important changes in market configuration, but within each there are segments that share life-style and specific psychographic needs (Kossoff, 1988; VanderMerwe and L’Huillier, 1989).

The internet network can also facilitate the internationalization process for SMEs. Poon and Jevons say that “internet has created unpredictable and unprecedented opportunities for SMEs and they can access to certain markets similar way as large enterprises and are able to engage international marketing which otherwise could have been unaffordable due to huge amount of resources required.”

The internet removes the communication barriers with consumers. However, Linda Svensson (1999) draws attention that SMEs, which are starting to use the internet for both domestic and international marketing, must understand how this new media differ from traditional marketing tools. “The ability to change is even more critical when being on-line since in the marketplace things change much faster than in traditional ones. To keep steps with this new powerful tool, major education and training is required to improve knowledge and
understanding in the area and to encourage more effective use of the internet to support SME internationalisation.”

As a conclusion, a SME has to face many challenges to success in its internationalization. Dr. Antal Szabó (2002) sums up all these barriers that must be overcome by the SME, from the most important to the least important: the lack of entrepreneurial, managerial and marketing skills, the bureaucracy and red tape, the lack of accessibility to information and knowledge, the difficulties to access financial resources (lack of capital), the lack of accessibility to investment (technology equipment and know-how), the non-conformity of standardization, lack of quality awareness and lack of mutual recognition schemes, the product and service range and usage differences, the language barriers and cultural differences, the risks in selling abroad, the competition of indigenous SMEs in foreign markets, the inadequate behaviours of multinational companies against domestic SMEs, the complexity of trade documentation including packaging and labelling, the lack of government incentives for internationalization of SMEs, and the inadequate intellectual property protection.

To leverage their resources and overcome barriers to internationalization, the SMEs have to success in the five following issues (UNECE, 2002): first they must build and obtain managerial skills, then they should prepare a good planning for their entry in the new market, find appropriate foreign strategic liaisons and partners, make sure of having the required technical capability and knowledge, and finally to have a quick adaptation and respond.

Many structures can help the SMEs to succeed in its internationalization. In France for instance, “Partenariat France”, “Francexport”, or the “Chambres de Commerce et d’Industrie” bring advice and support to the companies and can help them find networks and partners abroad.

Internationalization is indeed at the reach of SMEs. But because each SME is particular, there is no unique model to follow. Therefore a good preparation and good choices about the market and the partners are expected to increase the success degree of the SME internationalization.
References


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