SME INTERNATIONALIZATION: WHY, WHEN AND HOW?

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ABSTRACT

Internationalization is defined as a process of establishing networks of business ties in foreign countries through extension, penetration and integration (Ruzzier et al. 2006). There are common elements that every firm, based on its nature, has to consider before internationalization. This research paper explores some of the driving factors behind internationalization, modes of entry and the strategies implemented by firms in order to delve into foreign markets. Analyzing the literature available on Small & Medium Enterprise (SME) Internationalization, we try to put together a detailed study of information that could be useful to firms considering going global.

Keywords: SME, Internationalization, Globalization, Modes of Entry.

SME INTERNATIONALIZATION

Internationalization is a phenomenon, which is carefully observed from various viewpoints like strategy management, international management, organization theory and marketing. Internationalization is defined as a process of establishing networks of business ties in foreign countries through extension, penetration and integration. The factors associated with internationalization are international decision-making, development of activities, pros and cons of internationalization (Ruzzier et al. 2006). These are the common questions that every firm has to answer before internationalization.

Why SME?

This report will focus on internationalization of the small and medium enterprises (SMEs). SMEs, by number, dominate the world business stage. Although accurate data is difficult to obtain estimates suggest that greater than 95% of enterprises across the world are SMEs, accounting for
almost 60% of private sector employment (Ayyagari et al. 2011). Japan has the highest proportion of SMEs among the industrialized nations, accounting for more than 99% of its total enterprises (EIU 2010). India, according to its Ministry of Micro, Small and Medium Enterprises, had 13 million SMEs in 2008, equivalent to 80% of the nation’s businesses (Ghatak 2010).

The flat structure of SMEs and lack of hierarchy allows them to have a more flexible work environment and enables the top management to build a strong personal relationship with employees. In SMEs the employees are really close to the entrepreneur/owner of the firm. Risk taking can occur in situations where the survival of the enterprise may be in danger, or where major competition is disrupting their activities. By not having familiarity or knowledge about overseas markets, the entrepreneur or management team takes risk on decision-making (Masum and Fernandez 2008).

MOTIVES BEHIND INTERNATIONALIZATION

There are different motives behind the internationalization of SMEs. Most significant motive behind internationalization is to gain access to new and larger markets in order to achieve growth. Many firms go abroad to have access to know-how and technology in order to remain competitive. Resource based network theory (McDougall et al. 1994, Bloodgood et al. 1996, Westhead et al. 2001) says that resources play an important driver for motivating managers to adopt internationalization strategies. Firms with resources such as proactiveness, innovativeness, risk taking ability, global vision and foreign work experience (Freeman and Cavinusil, 2007) are some of the key factors behind internationalization.

When the firms plan internationalization, the management team has to consider the activities they should exploit in order to meet the market opportunity. There are two factors which stimulate the internationalization of SMEs and they are:

**Proactive factors:** Proactive factors indicate that the choice a firm has to internationalize is influenced by internal means- interest in exploiting unique ideas and competencies, as well as the opportunities that the foreign markets offers.

**Reactive factors:** Reactive factors to internationalize explain that firms can act passively and respond to both internal and external pressure: competition. A company having a unique product finds it easier to internationalize, as they get more enquiries from the foreign market for that product owing to its unique capabilities (Masum and Fernandez 2008).

![Fig. 1. Masum and Fernandez, Internationalization Process of SMEs: Strategies and Methods, 2008](image-url)
Modes of Entry

There is no correct or incorrect way to go global, it all depends on the firm’s age, resources, size and desire to market and the market itself. The ways in which a SME can enter the foreign market are as follows:

<table>
<thead>
<tr>
<th>Modes</th>
<th>Functions</th>
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<tbody>
<tr>
<td>Exporting</td>
<td>This is the route preferred by most of the SMEs to enter the international markets. This method avoids the cost of manufacturing in the host country but also can be a disadvantage if the cost of manufacturing is lower in the host country.</td>
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<tr>
<td>Turnkey projects</td>
<td>Turnkey project is a type of project that is constructed by a developer and sold or turned over to a buyer in a ready-to-use condition. Usually, in this type of project two entities/firms are responsible for putting up a plant or equipment. This type of entry mode is useful where the host country’s government limits foreign direct investments.</td>
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<tr>
<td>Licensing</td>
<td>It is an agreement where the licensor licenses his intangible intellectual property to a company/firm in the foreign country.</td>
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<td>Franchising</td>
<td>Franchising is a right that a firm acquires from another firm, which allows them to do particular business activities, such as selling their good or the service with defined protocols.</td>
</tr>
<tr>
<td>Joint Ventures</td>
<td>A joint venture is an entity formed by synergy of two or more independent firms working together. The firms agree to join together sharing revenues and costs, as well as the control of the new firm.</td>
</tr>
<tr>
<td>Wholly Owned Subsidiaries</td>
<td>In wholly owned subsidiary the firm own 100 percent of the stock.</td>
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(Mausam and Fernandez 2008).

SME INTERNATIONALIZATION STRATEGIES

Entry mode, scope, timing and pace of the international activities are some of the factors that SMEs have to consider before undertaking them. The Uppsala model states the process of internationalization followed by the companies. This is a staged model. In this model, SMEs first enter and commit resources in physically close markets and slowly, move on to the distant ones. This model is adopted by the traditional SMEs who tend to enter the foreign market very late. New ventures have challenged this model by entering foreign markets at the same time from the outset. The reasons for these new ventures to adopt the model of early entry into the foreign markets are the broad scope of the market they must compete in and also the availability of critical resources in those parts of the world providing them with the best supporting environment. With the advent of technology and spreading of supply chains, and organization of supporting networks across countries
firms have to follow their customers and accordingly internationalize based on their feedback (Jonas and Leo 2010).

Alternatively, the firm can adopt either sprinkler or waterfall strategy. Sprinkler strategy means targeting multiple nations at once. By adoption of this strategy the firms can benefit by seizing the market early on and maximizing sales by enjoying the first mover advantage in a particular country. The waterfall strategy on the other hand suggests slowly foraying from one country to next.

Following conditions favor the waterfall strategy:
- Very long life cycle of the product
- Low innovativeness in the foreign market
- Weak or absolutely no competitors in the foreign markets
- High fixed cost of entry into foreign markets (Jonas and Leo 2010)

The conditions that favor Sprinkler strategy:
- Universal usage of the product irrespective of the geographical variations.
- Smaller product lifecycle.
- Accommodating foreign market for the product.
- Relatively low costs involving the foreign market.
- Higher profits expected due to the maturity of the foreign markets.

Depending on the strategy opted and the timing of internationalization firms can be classified into four types. Following figure shows the four types:

![Diagram showing four types of firms based on internationalization strategy and timing]

**Fig. 2.** Jonas Onkelinx and Leu Slewaegen, *Internationalization strategy and performance of small and medium sized enterprises*, No 197, 2010

### PROBLEMS FACED BY SMEs IN INTERNATIONALIZATION

Although internationalization is one of the major driving factors for growth in SMEs, implementing such strategies might be challenging to the SMEs. The main reason for this is the difference between the international and the local markets. Due to these differences, the technical know-how and the capabilities that SMEs have developed for the local markets cannot be applied to the international ones. SMEs need to develop new skills and expertise related to the foreign markets and learn their local conventions. Other barriers that SMEs have to tackle in order to enter foreign markets are listed below: (Growing the global economy through SMEs, *Edinburgh Group*)
CONCLUSION

In conclusion, all the evidence reviewed for this report, from both previous studies and the newly conducted research, indicates that SMEs are important for economic success particularly when they become active on the international stage.

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