

THE III rd INTERNATIONAL ECONOMIC CONFERENCE ECONOMIC GROWTH IN CONDITIONS OF INTERNATIONALIZATION

SEPTEMBER 4-5 , 2008

THE INSTITUTE OF ECONOMY, FINANCE AND STATISTICS
CHISINAU REPUBLIC OF MOLDOVA

The Role of the Small and Medium -sized Enterprises in the Process of Internationalization

Prof. Eng. Giorgio TESELEANU Ph.D.
PRESIDENT CONCEPT & PANTHEONGROUP – ITALY,
UNIVERSITY OF MACERATA - ITALY

The Role of the SMEs in the Economy

The role played the small and medium - sized enterprises (SME) in the economy is very important because of the help that give for the economic development and the job creation. The SMEs, in both advanced market economies and economies in transition and their considerable contribution to employment and economic dynamism in the most industrialized countries suggest that this experience can be used for sustainable development of developing countries. It is clear that a vibrant SME sector can bring great benefits to developing countries.

The role of the SMEs in community development often remains obscured by the informal nature of their actions. However, there is quantifiable evidence exists in a number of studies on small business and the environment, providing a sense of how important this sector is for sustainable development in emerging economies.

SMEs are more likely to have ties of dependence and familiarity to their communities, which will ensure they protect their reputation and relationships among neighbours and customers. The aim is to improve the loyalty of the customers and to have better relations with the community.

In confrontation with market saturation or intense domestic competition, those firms that have the ability to identify and exploit exchange opportunities abroad therefore seek to maximize their profits by entering international markets.

Small and Medium - sized Enterprises – Definition

There are two groups of criteria to define the SMEs: **quantitative** and **qualitative**. From a **quantitative** point of view, the term SME refers to companies in all sectors as long as its size is not too big. There are some indicators used to create the definition of the SMEs: profits, invested capital, balance-sheet total, earnings, total capital, equity, market

position, production and sales volume, number of employees and turnover. But the most important quantitative criterias are: the number of the employees and the turnover.

Qualitative criteria generally provide information on the nature – the characteristic properties – of SMEs. In order to differentiate between SMEs and large companies, relationships between ‘owner’ and ‘company’ in the framework of ‘personal principle’, and ‘unity of leadership and capital’ are recommended as the qualitative criteria. The ‘personal principle’ means that the company manager performs a central role in the business decision making, he has an overview of fundamentally all technical, administrative and organizational procedures in the company. ‘Unity of leaderships and capital’ means that the company manager and proprietor is one and the same person, the owner-manager is much more self-sufficient and independent than the contracted management of large companies.

The European Union (EU) set the following criteria for defining the SMEs:

- 1) less than 250 workers;
- 2) a maximum of 40 million euros annual turnover;
- 3) a maximum 27 million euros annual balance-sheet total;
- 4) minimum of 75% of company assets owned by company management;
- 5) owner- 3

Internationalization of Small and Medium-Sized Enterprises - Dimensions

In the present world economy, no market is forever safe from competition and no company can afford to stake its future on the assumption that it ‘owns’ its home market. Therefore, due to increasing competitive pressure and protection they formerly received from their governments, it is particularly necessary for SMEs to internationalize in developing countries.

Because of the increasing competitiveness, the SME sector has become vital for the national economy due to their impact on job creation and increasing scope for success in export markets. Also in the international environment due to the changes and to the necessity of integration, consistent with other economies (developed, developing, and transition), a strong small and medium-sized sector is necessary for the eradication of poverty, specifically through employment generation, and for the restructuring of the institutional business framework.

Finally, and equally important, the development of new and existing export markets is seen as a powerful tool to promote employment creation. In order to cope with new situations, many enterprises have shifted their activities toward international markets. Such a shift in orientation towards more discerning and demanding export markets has forced the manufacturing sectors to strive for a substantial improvement in their competitiveness through adoption of different policies and strategies.

In the process of internationalization, an important question remains to be settled: why internationalization? What factors lead a firm from little or no involvement to, in some cases, widespread international involvement? Growth is not spontaneous, it is the result of decision; therefore, if we are to understand the processes then we have to explain *why* a company undertakes to become involved in international operations. It is not enough to be

a firm with resources and opportunities in the environment; internationalization must be wanted and triggered by an entrepreneur who makes key decisions and carries out the internationalization.

Thus, given the central role of entrepreneurs in internationalization of SMEs, it is important to clarify why entrepreneur undertakes to enter the international market and to identify the driving forces that influence the entrepreneur's perceptions, decisions and actions that consequently lead the firm towards involvement in international markets.

The process of internationalization of SMEs is an entrepreneurial and opportunity-based process. In this process, due to the initiating forces and entrepreneurs' alertness, entrepreneurs perceive and subsequently due to their skills and experience realize and take advantage of international opportunities. This is reflected in the receptiveness attitude, entrepreneurial orientation, proactive behaviour of the entrepreneurs and the international orientation of the firm. Therefore, it would appear that entrepreneurs generally have an impact on internationalization of SMEs in two different ways: one impact reflect the mental orientation or "*way of thinking*" and the other impacts indicate the behaviour and "*actionoriented function*" of the entrepreneur resulting in realization of the international market opportunities and internationalization of the SMEs.

Some firms may internationalize early because a top management team with previous international experience may be willing and able to pursue new combinations of key resources across national borders early on in the firm's existence. For instance, they argued that a firm might change gradually the nature of its activities *within* a foreign country, that is, from only export to fully-owned overseas production investments, as well as *across* countries by expanding over time to countries that are more physically and culturally. The team's level of international knowledge and experience has a positive influence on the firm's degree of internationalization.

On the contrary, other firms prefer to learn gradually about the international arena by entering first markets that are perceived to be less risky – that is, being geographically and culturally close to the domestic market – before entering "more risky" distant markets. In short, the behavioural approach towards internationalization focuses on a firm's gradually increasing international involvement through a series of incremental steps.

The internationalization of a firm is not a one-dimensional concept (to be analyzed only through the operation dimension) but a multidimensional concept, we should decide which dimensions of internationalization are of our interest. In comparison with decisions such as type of product, number and quality of personnel, organization structure, and financial issues that are common activities in any growth strategy, "entry mode" and "market selection" are considered as the core components and distinctive features of internationalization and other types of growth strategies. Entry modes are the institutional arrangements such as exporting, licensing, foreign investment, etc. that enable firms to enter a market. Therefore, in addition to the driving forces of the internationalization, we are interested to know *how* SMEs realize their operations (entry mode) and *where* they locate their operations.

The process of foreign investment decision involves "an intricate structure of attitudes and opinion, social relationships both in and outside the firm, and the way such attitudes, opinions and social relations are changing. It contains various elements of individual and organizational behaviour, influenced by the past and the perception of the future as well as by the present. It is composed of a large number of decisions, made by different people at

different points in time.” The huge number of variables influence the export behaviour of firms but simple listing of reasons for exporting, export stimuli, etc. is not likely to cause any progress in explaining or predicting the process of internationalization. A internationalization strategy consist of a combination of exportation, alliances and foreign direct investment strategies.

According to classical international theories, supply and demand opportunities drive the international exchange activities of firms. Taken together, they assume that international exchange opportunities exist, and the internationalization of firms arises largely from industry structure and market conditions rather than individual managerial factors.

The process of the internationalization can be described as a gradual acquisition, integration and use of knowledge about foreign markets and operations that is organized around strategic choices and organizational forms, which are influenced by many other factors as well.

These factors include forces facilitating or inhibiting exporting, information needs and the acquisition of information, foreign market selection and entry (including the effects of cultural distance), expansion, and marketing strategies.

Exportation was the internationalization strategy the most utilized. This is followed by the distribution rights strategy and importation strategy.

The main factors that must be analyzed when someone decides to tackle with the international market are:

1. Exports

The first obstacle for the SMEs is the lack of knowledge of the foreign market and then the import tariffs in destination countries and the lack of capital.

2. Strategies against increasing competition

The best way to fight the increasing competition is to improve the quality of the product, to increase working hours and to cut the production.

3. New products and the barriers to innovation

Innovation is very important for the company because a new product produce much income. But the barriers are: the access to finance, the scarcity of skilled labour, a lack of market demand and the high cost of human resources.

4. Dependency from regional markets

For a successful international business, the SME doesn't have to be dependent on the regional market

5. Availability of an appropriate workforce

A primary problem is the availability of an appropriate workforce. Finding and hiring the appropriate workforce is a challenge for many SMEs in the EU.

6. Administrative regulations

Administrative regulations have a considerable importance for the company because this is one of the main issues that limits the business.

Companies invest abroad in order to lower transaction costs through two effects: the location effect and the ownership effect. The location effect determines where value-adding activities take place and the ownership effect explains who owns and controls the activities.

Investment abroad is motivated also by attempts to guard assets such as information, skills, technology or products, or to obtain control over resources, thereby protecting the firm from uncertainty and reducing transaction costs. The rational ability of the firm to assess the costs and benefits of internal and external transaction costs and to implement decisions is considered implicit in these motives.

There is a certain number of dynamic factors which explain why an important number of enterprises choose to progress gradually in their internationalization process. These factors are:

- resource availability,
- the level of foreign market acquaintance,
- the importance of communication networks,
- the perceived risks and/or incertitude,
- the willingness of the manager to enter foreign markets.

Learning about the organization of a company is very important. Organizational learning effort is based on existing knowledge and developing new knowledge. This description of learning effort is consistent with prior research that argued that organizational learning includes two modes, that is, exploitation and exploration.

Exploration involves the search for new knowledge, skills and processes, whereas exploitation involves the incremental improvement of existing knowledge, skills and processes. But many times exploitation by itself may not be sufficient in the long run to maintain a competitive advantage, since the environment in which an organization operates changes over time. Such effort may be aimed at learning inside home country borders (that is, domestic learning effort) or outside these borders (that is, international learning effort).

In order to examine the impact on future internationalization of how much emphasis a firm places on learning activities in general, we also examined the effects of *domestic* learning effort on a firm's internationalization intent. We suggest a positive relationship between domestic learning effort and the propensity to internationalize further. By emphasizing domestic learning activities, the firm may indirectly become more knowledgeable and confident about how to learn from its current and potential stakeholders (for example, personnel, customers or suppliers) in the domestic market.

As firms acquire knowledge in their domestic market, their knowledge base may expand such that it provides the firm with better in cross-border activities. Some significant factors

must be taken in consideration: local competitors, competitive agreements, legislation and business norms that are used.

Uncertainty in foreign markets may be overcome by exchanging information with organizations who are more familiar with the specific local context. Therefore, when a firm *proactively* seeks for additional foreign suppliers, customers, and alliance partners in a given country, a firm may overcome the uncertainty that arises when increasing the intensity of its activities in that market.

The notion of *proactiveness* reflects the firm's propensity to undertake a continuous search for opportunities and reflects the fact that the company monitors environmental changes in a variety of countries on a frequent basis, even if it has not undertaken any formal business transactions in those countries yet or does not intend to do so in the short term.

There are also risks that the company must consider when it decides to internationalize.

SMEs are considered to be at a greater risk of failure, partially because company directors may have less collective management experience or business expertise than larger companies. Foreign investors often shy away from investing in emerging economy SMEs because of unfavourable investment climates and the uncertainty of sufficient returns. The result is that some SMEs secure financing only by agreeing to a high amount of collateral and shorter pay-back periods while the rest must either rely on their personal networks or high-interest, illegal loans to generate start-up capital.

Also the size is a disadvantage for the SME because it doesn't have enough information and enough financial resources for implementing direct investments.

Firms that engage in radical innovation, undertake bold, aggressive actions, or are willing to assume risks, may be more likely to develop a long-term business abroad, substantial presence in the international countries, compared to firms that are more reactive or conservative.

The internationalization process in the European Union

Since 1992, the European Union (EU) has become a reality for European firms. Within this free trade zone, even more steps are being taken to unite the countries, both economically and politically. This transition changes the national and international business environment. For small and medium-sized firms - and for their competitors - it has become easier to broaden the firm's activities internationally. Besides the establishment of the EU, the democratization of Eastern Europe also brings new opportunities as well as threats, because some of these countries are likely to enter the Union.

Several theories and concepts have been suggested to capture the process of internationalization. Among these, the so called stage models receive much attention. These theories assume that the process of internationalization should follow a prescribed path to be successful.