

The Internationalization Process of SMEs: A Relationship Approach

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Whenever new subjects and concepts are proposed it seems fair to ask what is different from what we already know. The starting question thus, for an analysis of international strategies is, what is the difference between traditional MNEs and so called BGs? According to traditional theory, MNCs have had a slow and gradual development from national company, to internationally and finally when they have got the experience and the finances to take the final step, they become large multinationals. BGs on the other hand, are, per definition, global more or less from the start i.e. they have not followed the slow and gradual steps as the traditionally MNCs supposedly have.

Traditional internationalization theories describe a process in which the firm gradually becomes involved in international business and enters foreign markets, and this view seems to enjoy general acceptance among most international business scholars; *“..the slowness of the whole process is a consequence of incremental adaptations to changing firm and environmental conditions rather than the result of a deliberate strategy”* (Knight & Cavusgil, 1996:13). This view is up for revision, since 1989, reports based on case studies of international new ventures, that is ventures that are international at or near inception, have begun to appear... *“...reports indicate that evolutionary internationalization still appears to be the norm around the world for most small and medium sized enterprises, but evolution is accelerating. Furthermore, a small but growing group of those ventures are global at start-up,”* (Oviatt & McDougall, 1997:88). The born global firm and its activities are just beginning to emerge as a research area (Harveston, 2000), and it seems as the risk-averse and incremental nature of internationalization described by traditional process theory may be inadequate for explaining this phenomena.

Born Globals

The international arena was once thought to be off limit for new firms – today some researchers estimate that up to 25% of the emerging exporters are born global (Harveston, 2000). I seek to find an explanation for how such internationally fast growing, small firms with little (financial) resources and international experience are able to succeed in a global marketplace despite these weaknesses. How and why do these companies (BGs) deviate from the mainstream internationalization pattern? The aim of this study, thus, is to further develop theory on the internationalization process of firms and to get a greater understanding of the relatively new phenomena, born globals.

The answers may at least partly be found in the firm's relationships. One research question is thus: how do business relationships influence a firm's international strategy? And, which type of alliance is best under which circumstances?

"In the new global economy, there is no place for companies to hide from foreign competitors - all companies need to plan for growth and survival in a world of global competition" (Root, 1994:21). Despite the importance of SMEs to international marketing, little is known about how they prosper under globalization or about globalization's moderating role on entrepreneurship and marketing strategy – according to Knight (2000), most SMEs are disadvantaged in an increasingly global environment because they lack the resources of large multinationals. Solberg (1999:27) defines globalization as *"a development where the boundaries between the different countries in the world are increasingly blurred and the competition have become more international"*. Waters (1995) states that one manifestation of a globalizing world is the emergence of entrepreneurial start-ups that have an international outlook from inception. Thus, another research question is; how do Norwegian SMEs respond to the increasing degree of globalization? And is the emergence of born globals an inevitable consequence of it?

With regard to the market selection dimension, BGs often start activities in many markets fast (simultaneously) and not always in close markets first. The product is often developed for a global-/international market (Madsen, 1999), and not as traditionally, for testing out at in the home market first. Bell (1995) explains this in the following way: *"..psychic distance has become much less relevant as global communication and transportation infrastructures improve and as markets become increasingly homogeneous"*, (p.62). Hedlund & Kverneland (1985) also provide evidence of a speeding up of the internationalization process and posit that: *"the establishment and growth strategies on foreign markets are changing towards more direct and rapid entry modes than those implied by theories of gradual and slow internationalization processes"*. According to Young (1987), this is most likely to be manifest among high-technology firms where high R&D costs, shorter product life cycles and a concentration of the market for high-technology products accelerate the pace of internationalization. The same suggests that such alternative strategies may be

licensing and JVs, they see evidence of such modes being adopted more widely by smaller firms as initial foreign market entry mode.

Contribution

My main contribution will be to develop new theory on internationalization processes for SMEs that is more up to date with today's increasingly global environment. The study will hopefully also be of some use for managers of Norwegian SMEs. Managers of BG firms who seek rapid internationalization may need to emphasize different resources and capabilities than managers of gradual globalizing firms who seek more cautious internationalization. They also need information on how best use their scarce resources in order to facilitate the internationalization process.

Conceptual framework

Empirical evidence from many countries supported the notion that firms often internationalized like "rings in the water"; their market knowledge increased gradually and hence uncertainty as well as risk is reduced over time for each country market. However, in 1988 Johanson & Mattson pointed out that some firms follow other internationalization patterns. They argue that the degree of internationalization of markets (i.e. the frequency, intensity, and integration of relationships across borders in the particular industry market) has an impact on the internationalization process of the individual firm. In highly internationalized markets, firms may leapfrog some of the stages or rings in the water. More recently many authors, (f.ex. Oviatt & McDougall 1994; Knight & Cavusgil, 1996), have found empirical evidence of yet another type of exporters often labeled "born globals", which aim at the international markets or even the global market right from their birth and do not seem to follow any kind of stages e.g. they go beyond leapfrogging. This may at least partly be explained by the fact that professionals with cross-national experience and inter-cultural competence are available in much larger numbers than just ten years ago and also founders of new companies have much more elaborate international experience, skills and networks than previously (Madsen, Rasmussen & Servais, 1999). My focus in this paper will be on the networks.

The existing literature has not reached to an agreement on which conceptual framework and constructs should be used to explain a firm's foreign market entry mode (Andersen, 1997). The present framework will be based on my perception of the most important

contributions to explain the internationalization pattern (i.e. entry modes and foreign markets selected) of small, fast globalizing firms. Crick & Jones (2000) found that decisions to enter markets with a perceived low psychic distance were less important than decisions based on global trends in technology markets and relations in networks. The markets served were perceived to be those with growth opportunities for a firm's particular niche products, i.e. the desire to be close to particular customers played a major role in the decision to invest in subsidiaries overseas. Initial modes of market entry tended to be limited, but the types and pace of further internationalization varied. Internationalization was found to be much less deterministic than conventional wisdom – there was evidence of an international orientation from the date they were founded. Knight (2000) also states that advance planning and allocation of appropriate resources are more likely to lead to a successful internationalization experience. Planning thus, can be seen as of particular benefit in international ventures compared with domestic business, because global conditions are likely to be much more complex than those in the home market.

Madhok (1997) present the organizational capability perspective as an alternative to TCP, while Aulakh & Kotabe (1997) have perceived it more to be complementary. The perspective which has dominated the outpouring of literature on global strategy over the past decade has been economic (Collis, 1991). The internalization theory is considered to be the TC theory of the multinational corporation and research on the topic of entry mode has predominantly been from this perspective (Madhok, 1997). This perspective analyses the characteristics of a transaction in order to decide on the most efficient i.e. TC-minimizing, governance mode. But lately, there has been increasing attention to the notion of firms competing primarily on the basis of capabilities. This argument is rooted in the resource-based perspective (Penrose, 1959). In this perspective the historical dimension of a firm's activities is critical, since its past experiences engender the underlying routines on the basis of which it undertakes subsequent actions. While the key consideration of the TC approach in selecting entry mode is cost minimization – the OC perspective focuses on the value of the firm's capabilities. The focal concern shifts from the extent TC saved by not conducting the transaction through the market mechanism to the extent of value sacrificed, in terms of overall rent-generating capacity, by not conducting the transaction within the firm. The OC perspective shares the notions of bounded rationality with the TCP and the eclectic perspective, but reject the

assumption of opportunism, which is central in the TCP. The OC perspective is rooted in the resource-based theory and shares the emphasis on experiential knowledge with the Process Theory on Internationalization.

Madhok (1997) believes the assumption of opportunism, is not required, he claims that the very fact that collaboration is increasingly prevalent especially in globally dynamic and knowledge-intensive industries, suggests that firms are willing to trade off some potential losses from opportunism for the opportunity to develop their capability base. Burgel & Murray (2000), suggest that an organizational capability perspective on young, resource-constrained, technology-based firms' behavior offer a better explanation of their entry decisions than either transaction cost or stage theory.

My conceptual framework is constructed as a preliminary response to the research questions, and thus should serve as the basis for the research design and help me to focus on relevant issues in my empirical research.

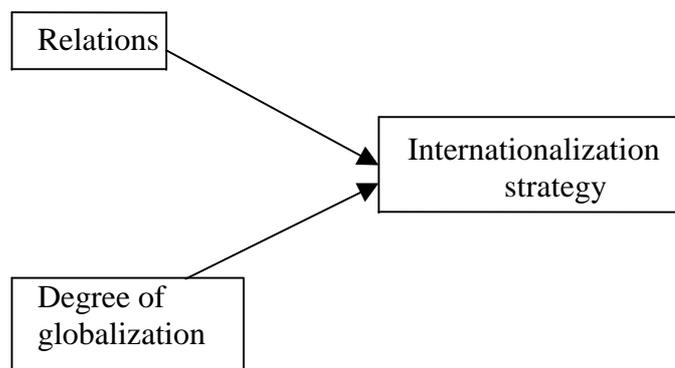


Figure 2: Conceptual Framework

The Relationship Approach

According to Moen (2000) there are numerous studies that have focused on the strategy-performance relation and there is strong support to the notion that strategy affects performance i.e. it is important to study which strategies are used and what influence them. I define strategy as a firm's pattern of entry modes and subsequent foreign operation modes chosen and which market(s) are entered when over some time period.

Jolly (1989 in Junkkari, 2000) sees the growth in alliances as a direct result of globalization. The global logic of strategic alliances is based on the observation that the fixed costs of manufacturing, R&D, building and maintaining a brand, and operating a sales and distribution network on a global scale are too high for most companies to bear alone. When considering the limited resources of born globals one can assume that all types of co-operative modes, ranging from partnership agreements through strategic alliances to networks, will play an especially important role in the implementation of their globalization strategies. It has been argued that interorganizational learning is critical to competitive success. Von Hippel (1988) found that more than two-thirds of the innovations he studied could be traced back to a customer's initial suggestions or ideas. Several studies suggest that a firm's alliance partners are, in many cases, the most important source of new ideas and information that result in performance-enhancing technology and innovations.

There is considerable literature on corporate alliances, but less on when it is better for a firm to choose an alliance over its fully-owned operation, or vice versa, and very little indeed on which type of alliance is best under which circumstances (Contractor & Kundu, 1998). Andersen (1997) believes the OC theory has the potential to predict what type of co-operative mode that a firm will select, by further discussing different types of capabilities.

Degree of Globalization

Modern communication has increased people's awareness of other nations. In addition transport has become easier and, hence, travelling for business and private purposes have both become more frequent. The current phase of liberalization is supported by rapid progress in technology in telecommunications and transport services. According to Alahuhta (1990), this ongoing globalization is believed to have an important impact to the nature of competition.

A common definition of globalization is as a process in which the constraints of geography on social, cultural, political, and economic arrangements recede (Waters, 1995). Boundaries between domestic and international markets are becoming less relevant as businesses increase their profiles abroad. Globalization is associated with governments reducing trade investment barriers, large firms manufacturing in multiple countries, local firms sourcing raw materials or parts from cost-effective suppliers

abroad, and foreign firms increasingly competing in domestic markets (Dunning, 1993). The degree to which these developments have occurred in a SME's potential market, obviously has a large influence on the firm's route of internationalization, I have therefor decided to control for this factor when testing the model.

Global presence does not necessitate ownership of foreign operations; it can also be achieved through a variety of collaborative arrangements – the latter may be especially attractive option where the knowledge creation and exploitation processes in a particular sector are deeply “embedded” and comparatively opaque to outsiders (Madhok & Osegowitsch, 2000).

P1a

When large degree of globalization in a market we are likely to observe growth in alliances.

P1b

Large degree of globalization in a market will lead to increased presence of BGs.

Resource availability has not been a particular focus of much of the research on internationalization, but it is nevertheless an important issue to consider (Benito & Welch, 1994:13). F.i. smaller firms, given their limited financial resources, can be expected to face a narrower set of viable foreign market servicing options than larger firms (Bonaccorsi, 1992). Still there is evidence of such firms succeeding in international markets. Knight (2000) claims that the success of SMEs under globalization depends in a large part on the formulation and implementation of strategy. I define a firm's international strategy here as the pattern of entry modes and subsequent foreign operation modes chosen and which market(s) are entered when over some time period.

A common assumption seems to be that firm size is one of the factors influencing the strategic options available and that firms should develop export strategies that reduce their size disadvantage if they are small and have limited resources (Moen, 2000). Madsen, Rasmussen & Servais (1999) found that BGs were quite consistent in choosing foreign distributors as their main export channel – they thought this was not a very

“global” way of governing foreign operations. This may be explained by the fact that BGs often operate on many different markets which are all important to them. Due to their limited resources, they are not able to invest in market knowledge and market infrastructure on all markets – they are often only able to invest in close market contacts in very few countries. Such factors may force them to use more low-commitment type of operation mode, in addition they may not need or want a sales subsidiary since their targeted market segment may be too small to justify the investment.

Thus, one reason for the difference observed, between traditional MNCs and BGs, may be that BGs are much younger companies that have not yet got the financial resources to invest in sales subsidiaries. Another explanation may be, as mentioned above, that such investments are not economical because their product is targeted towards a very narrow segment which cannot generate sales enough to warrant the establishment of sales subsidiaries in each single foreign market. Therefore, the BGs must rely on less capital intensive and more low-commitment type of modes such as cooperation with foreign distributors instead. Very young firms are not supposed to have established subsidiaries, but since these (BGs) are very global (despite their young age) and one characteristic of very global/international firms are that they have established subsidiaries or even local production units they diverge from the pattern of other very international firms. To explain why some SMEs still follow a more step-by-step approach while others choose the faster and more erratic approach of jumping stages, Madsen et al (1999) argue that the development (globalization) may enable firms to more freely choose their own model of becoming international. International sales both become easier and more difficult in that international markets have become more accessible for most firms – while on the other hand the degree of competition and demands for international competence has increased. From this discussion follows two propositions;

P2

SMEs that fit the definition of BGs are likely to mainly make use of low-commitment modes.

P3

SMEs that fit the definition of BGs are just as likely to go to markets far away from the home market, in terms of psychic distance, as close by.

One common solution, which is particularly prevalent for small internationalizing firms, is to engage in interfirm co-operation to grow with the aid of a partner's resources – resource sharing has become a primary explanation for interfirm co-operation. Dyer & Singh (1998) state that both the industrial organization view and the resource-based view ignores the fact that the (dis)advantages of an individual firm are often linked to the (dis)advantages of the network of relationships in which the firm is embedded. This, they claim, is due to the fact that a firm's critical resources may extend beyond firm boundaries. Thus, idiosyncratic interfirm linkages may be a source of relational rents and competitive advantage. Madhok (1997) also believes it is due with a change in focus, he states that the difference in orientation from cost to value most probably will change the stance toward collaborative activity. This brings me on to the second independent variable.

Business Relationships and Foreign Entry Mode

What has been regarded as one of the fundamental principles of organizational design is that organizations react to uncertainty in their environment by removing transactions from the market and placing them in more hierarchical contexts (Williamson, 1975, Ouchi, 1980). More recent research has started to question the generality of this principle by showing that – when market uncertainty increases – individual companies tend to interact more, rather than less, with other organizations. The main effect of market uncertainty is thus, not the absorption of the source of uncertainty within corporate boundaries, but increased reliance on external partners who are known and trusted as reliable (Baker, 1992).

Sheth & Parvatiyar (1995) state that there has been a significant shift in the axioms of marketing; “from competition and conflict to mutual cooperation, and choice independence to mutual interdependence” (p.399). Relationship marketing believe that mutual cooperation, as opposed to competition and conflict, leads to higher value creation (Morgan & Hunt, 1994). RM marketers believe that interdependencies reduce transaction costs and generate higher quality while keeping governance costs lower than exchange marketing (Heide & John, 1992; Williamson, 1985) i.e. better quality at lower

cost is achieved through interdependence and partnering among the value chain actors. The notion of relationships does, according to Håkanson, Anderson & Johanson (1994:2) “indicate that firms do not treat the environment in a generalized or standardized way, but that they interact with specific “faces” “. The network perspective has moved away from a “faceless” environment towards a more specified environment made up of identified counterparts.

“Much of the critical information and knowledge about foreign markets is contained in the networks that a company is able to develop – anchored by key actors within them” (Benito & Welch, 1994:14). I.e. network development emerges as an additional (in addition to experience as is the main explanator used in the traditional internationalization theories) explanatory factor in the ability and preparedness of a company to expand its foreign market servicing commitments. “*Cooperation justifies itself.....as a means of overcoming the limitations – restricting what individuals can do*” (Dahlqvist, 1996:7). If a firm possesses some but not all needed resources, a common response is to combine resources with an external organization using a co-operative arrangement. For the resource-constrained firm, the primary advantage of this tactic is that markets can be entered more quickly than if full ownership is used.

The common factors are that business relationships are characterized as *close*, with *frequent interaction* and *mutual dependence*. A paradox is that on the one hand dependence ties actors together and connects relationships, working as a stabilizing factor. On the other hand, it brings dynamism to relationships by constituting a condition of obtaining the experiential knowledge, which is crucial to future actions such as foreign market development. Blankenburg-Holm & Erikson (1996) investigated how certain characteristics of the foreign customer relationship are related to the customer’s role in the supplier’s foreign market development. By foreign market development is meant developing business opportunities in the foreign market. They found that the specific customer relationship is an important link to the foreign market as it creates the experiential knowledge necessary to develop that market. They further state that as long as the dependence is mutual, the advantages are considerable for the supplier’s foreign market development.

Internationalization, according to network theory, means that the firm establishes and develops network positions in foreign markets. This implies that the firm's progress and route towards internationalization depend on the current network situation. In my case, due to my focus on the individual level, it will be the personal network of the founder or other key personnel. In other words, instead of the firm's position in a network, founder's position before the internationalization process begins will be of great interest, since it indicates market assets that might influence the process.

P4a

Founder's or key employees' business relationships (network from current and previous employment) influence SME's internationalization strategies.

P4b

The relationships may enable the firms to *enter* new markets at a *faster* rate than otherwise possible (e.g. by providing firm with complementary resources and by opening up markets).

Method

The purpose of this study is first of all to establish the existence of so-called born globals in Norway and furthermore to try to explain how and why these companies deviate from the mainstream internationalization pattern.

I will start out with a survey of a sample of the SME's in Norway, which fit my definition of a born global. After this survey has been carried out and the answers analyzed, a more qualitative type of study will be carried out to validate the conclusions made from the survey. In the second study some 20 founders of the initial sample will be selected and asked more in-depth questions of their firm's internationalization process. The founder's answers will be compared with the analysis made from the first study.

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