Internationalization of Small and Medium-sized Enterprises: Barriers and Economic Incentives

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Abstract

Enterprise leaders may improve outcomes and avoid costly mistakes through understanding of economic incentives and barriers to international expansion. Conclusions from a research study of small and medium-sized South Carolina enterprises were triangulated with prior research to highlight leader internationalization experiences. The globalization phenomenon of world markets is a persistent trend that is accelerating. Growing global markets are linked to increased opportunities for smaller enterprises to participate in international commerce. Limited understanding of incentives that enable success and techniques effective for overcoming barriers may restrict smaller firms from rewarding participation in international markets. Not all commercial enterprises are prepared organizationally nor properly resourced for international success. Those firms that may benefit by accessing larger customer pools or expanded *global supply networks may achieve higher levels of enterprise success by overcoming barriers to new international market commerce.*

Keywords: Internationalization, Small and Medium-sized Enterprises, International Commerce, Business Networks, International Expansion Leadership, International Decision-making, Barriers to Commerce, Economic Incentives, Global Supply Chains

Introduction

Firms with fewer than 500 employees are the most frequent form of enterprise defined by number of employees, representing 97 to 99% of businesses in market economies (Kumar, 2012; K. London, 2010; Tesfayohannes & Habegger, 2011). These small and medium-sized enterprises (SMEs) provide the majority of employment opportunities—from 51 to 86% of all jobs in major market economies—yet only eight percent of small enterprises report revenues from exports (Tesfayohannes & Habegger, 2011; Vasquez & Doloriert, 2011; Wright, Westhead, & Ucbasaran, 2007).

Decision-makers for small business have limited resources when contrasted to large enterprises (İPlİK, 2010; Rodrigues & Child, 2012). Small businesses are characterized as founder-directed, entrepreneurial, nimble, flexible, niche marketers, and learning organizations (Kontinen & Ojala, 2011). Leaders of small firms also are less able to guide the firm to economies of scale, attend less effort at international market scanning, and are less able to address large or risky projects (Nkongolo-Bakenda et al., 2010; Wright et al., 2007). Leaders of SMEs make choices for the use of firm resources based on subjective expected utility, evaluating the relative expected benefit and likelihood of accomplishment between alternatives (Fisher & Lovell, 2009; Wright et al., 2007).

Expansion by SMEs into markets beyond home country borders follows patterns described as proactive market-seeking, reactive, and client-following (K. London, 2010). SME leaders may choose to engage in international business to pursue opportunity, at the request of historical customers who initiate operations in foreign markets, and in response to competitive market pressures (Hynes, 2010; Rodrigues & Child, 2012). Decision-makers may also choose to not pursue international markets due to sufficient domestic market opportunities: "most stay at home" (Wright et al., 2007, p. 1017). Leader prior experience and foreign market relationships are associated with enterprise movement into international markets (Agndal & Chetty, 2006; K. London, 2010).

Leader experience is a major factor in the ability of decision-makers to identify opportunities and to structure the firm for success in foreign markets (Wright et al., 2007). The SME decision-maker desire to internationalize is often accomplished with assistance gained through relationships; customer, supplier, or professional contacts serve as a catalyst to launch new international commerce (Agndal & Chetty, 2006). Leaders determine specific markets for expansion, basing their decisions on conditions that attract or repel entrepreneurial interest including business factors, chance opportunity, psychic distance, politics, or structural conditions (Agndal & Chetty, 2006; K. London, 2010; Sherriff, Brewer, & Liesch, 2010).

The decision to launch an international initiative for a small or medium-sized enterprise represents both opportunity and risk for the firm (Lee, Kelley, Lee, & Lee, 2012). The low percentage of all SMEs involved in international commerce is indicative of the choice by most decision-makers to address only domestic markets. Increasingly, however, globalization is encouraged by the adoption of standard business languages, ease of electronic communication, and reduced trade barriers resulting in rising opportunities for cross-border commerce (Khapne, 2012).

Internationalization

The decision to expand internationally is no guarantee for the success of a new international venture; however, successful expansion into international markets may significantly increase total opportunity available to a firm (Lee et al., 2012; K. London, 2010). "Growth is a multi-faceted phenomenon that is commonly associated with firm survival, achievement of business goals and success, or scaling of activities" (Hynes, 2010, p. 89). Foreign activities necessitate the commitment of resources and may involve risk to the firm, increasing the interest and value of organizational knowledge for ventures active in economies beyond the domestic market.

Theories of internationalization began with the work of Johanson and Wiedersheim-Paul (1975) who first introduced research on the sequential, international, expansion experience of Swedish product-producing companies. The work by Johanson and Wiedersheim-Paul, and additional analysis by Johanson and Vahlne (1977), has been generalized to describe the internationalization experience of product-producing enterprises. Subsequent scholarly work explored additional aspects of internationalization, including born-global and rapidly expanding new firms aided by electronic communication.

Uppsala Stage Theory

Johanson and Vahlne (1977) published research on Swedish firms that expanded from historical service of the domestic Swedish market to participation in international markets. The theory known in scholarly literature as the Uppsala stage theory, links to the association of the authors with the Swedish University of Uppsala. The germinal theory is a *stage* theory; the authors showed the international expansion of the studied firms to occur in stages defined by time, commitment of resources, and the development of international market knowledge (Johanson & Vahlne, 1977). Firms researched by Johanson and Vahlne included Sandvik, Atlas Copco, Facit, and Volvo, and built on prior research on the same companies by Johanson and Wiedersheim-Paul (1975). Each of the firms included in the study increased in international exposure according to a particular pattern:

a) Initiating international activity through export sales, followed by
b) The selection and development of a foreign representative,
c) The subsequent establishment of a sales subsidiary, and, finally,
d) The commitment of a foreign direct investment of resources to produce goods and services in the foreign country.

Uppsala stage theory includes the researcher hypothesis that psychic distance between people groups impedes entry into a new foreign market. Psychic distance is a construct used by scholars to describe differences in the norms of two people groups and is a factor that limits the free flow of information between people in two economies (Johanson & Vahlne, 1977; Johanson & Wiedersheim-Paul, 1975). Language, custom, social norms, education, business practices, and political barriers are factors that require experiential learning for people to master. Equally, experiential learning is a necessary factor for the successful transfer of the particulars of internal knowledge within the internationalizing firm expanding into a new market. The two-way acquisition of knowledge of the foreign market and of the firm that wishes to expand requires time-based development. Personal contact by market participants develops experiential learning of foreign markets, which committed activity and direct resources placed within the expansion market reinforces.

Johanson and Vahlne (1993) theorized that the internationalization of firms is a process, which begins with the acquisition of market knowledge and continues with incremental commitment of resources, thereby providing a feedback loop of additional knowledge to reinforce further commitment. The authors concluded that the process, one of double-loop (Argyris, 2002) and triple-loop learning (Senge, 2006), might not be abbreviated or accelerated. The necessary form of market knowledge is experiential and a tacit understanding that cannot be transmitted otherwise.

The Uppsala stage theory continues as the prime theory of the internationalization process for enterprises that produce a physical product and involve the commitment of capital assets (Oviatt & McDougall, 1994; Oviatt & McDougall, 2005). Subsequent research recording the international expansion of service firms and those that provide intangible products has challenged the theory for exclusivity (Knight & Cavusgil, 2004; Knight & Cavusgil, 2005; Oviatt & McDougall, 1994).

The Internationalization Continuum

Cavusgil (1980) built on the work by Johanson and Vahlne to introduce a continuum of activity for the internationalizing firm. The process of international growth is "…a gradual process, taking place in incremental stages, and over a relatively long period of time" (Cavusgil, 1980, p. 273). For manufacturing enterprises, the graduated progress to foreign market effectiveness is decades-long (Ohmae & Rall, 1987).

Beginning with a domestic focus, ventures first satisfy opportunities in the home market, and where the local market matches the ambition of the entrepreneur, the firm may never choose to venture beyond the local economy. Leader curiosity about foreign opportunity may augment focus on the domestic market. The second, pre-export internationalization stage includes knowledge and information gathering activity by the enterprise leader. For example, a business owner may pursue chance contacts with peers from international markets through informal encounters at trade shows or training symposia. Networking with knowledgeable people and their organizations is part of the first stage of developing needed social capital to assist a new international venture (Rodrigues & Child, 2012).

Pre-export activity may develop through leader predisposition toward international activity because of personal travel, a foreign living experience, speaking a second language, or ancestral heritage (Cavusgil, 1980). Experimental international involvement in foreign markets is a stage frequently initiated through an unsolicited order from an international customer (Johanson & Vahlne, 1977; K. London, 2010). An established domestic customer of a domestic-market supplier may launch international operations and invite the trusted local supplier to support the foreign location as well. Similarly, an import company in a foreign nation may acquire a good produced by a domestic-only firm resulting in an initial unsolicited export order. In each of the described examples, the enterprise leader may fulfill the foreign order as an experimental business activity to satisfy curiosity about foreign markets, or may respond to the simple profit incentive presented by an unanticipated order from a foreign market (Cavusgil, 1980).

Knowledge gained by domestic-focused enterprise leaders in the pre-export and experimental stages of internationalization may stimulate leaders to initiate purposeful programs of export commerce. Leaders of companies who direct expansion into foreign commerce choose markets for initial activity that are regionally proximate and culturally similar to the home market of the new international entrepreneur (Aspelund & Butsko, 2010; Cavusgil, 1980; Chetty & Campbell-Hunt, 2003; Sherriff et al., 2010). A distinct offering or particular competitive advantage may be a basis for a firm to export, and accelerate the acceptance of the product by consumers in the import marketplace. Increased resource commitment and leader involvement in the development of a foreign market builds knowledge of the expansion market (Cavusgil, 1980; Johanson & Vahlne, 1977). Successful experimental efforts at international activity and the accumulation of tacit knowledge prepare people in the organization for the committed-involvement stage of internationalization.

Organizations often must be redesigned to accommodate a committed engagement in international commerce; the risk and effort required to thrive in foreign markets may exceed that of the domestic market, requiring leaders to adjust product, staffing, and business practices (Cavusgil, 1980). Committed engagement in foreign markets is a form of feedback loop of knowledge acquisition leading to further resource commitment described by Johanson and Vahlne (1977). Continuous and expanding international market involvement represents the final, committed stage in Cavusgil's continuum.

International New Ventures

Oviatt and McDougall (1994) concluded through their research the necessary and sufficient conditions for the success of an international new venture:

a) Underserved market opportunities exist in accessible international markets.
b) Because of limited resources, the new venture achieves control of needed foreign assets without direct ownership.
c) The international form of the organization is a competitive advantage.
d) The expanding firm controls unique and inimitable resources.

The speed at which international new ventures (INVs) engage in international commerce when contrasted to the incremental and cautious internationalization described by the Uppsala theory defines INV as competing theory of international growth. Hagen, Zucchella, and Larimo (2010) conducted cluster analysis of internationalizing firms in Italy, Finland, Greece, and Switzerland; findings in the study supported opposing developmental patterns, with one group strongly internationally entrepreneurial and other groups reactive and non-strategic. Spence, Orser, and Riding (2011) found international new ventures to be larger in terms of full-time equivalent employees and financial parameters when compared with domestic new ventures of the same age. The identification of markets that did not previously exist and the development of a truly unique product or service are two compelling reasons for entrepreneurial SME decision-makers to enter international markets.

Due to resource constraints, leaders of international new ventures develop network or partner associations to gain access to needed resources a start-up firm cannot provide. The unique resources controlled by the new venture define the attractiveness for pooling network resources. The new firm quickly expands internationally through use of distribution and license agreements, contract manufacturing, and simple export. A market-leader position for the unique product or service to be introduced to global markets is important for new international ventures. Value chain activities are unbundled so that the firm may penetrate new markets without the time-consuming, incremental expansion defined by stage-theory internationalization (Oviatt & McDougall, 1994).

Scale and depth of resources are not attributes of small businesses; rather, SMEs commonly operate with poverty of resources and organizational power (Knight & Cavusgil, 2005; Oviatt & McDougall, 1994). The successes of smaller firms organized to succeed in international commerce from inception were studied by Oviatt and McDougall (2005); the researchers discovered cases wherein the international development of subject firms was shown to skip steps or bypassed the sequence of stage-theory internationalization altogether. A resulting theory of international new ventures (INVs) provided a second potential path to international market entry. Developments in technology and economical access to world markets opened for SMEs the possibility to compete effectively with larger enterprises in multiple global markets (Rennie, 1993). “Internationally experienced and alert entrepreneurs are able to link resources from multiple countries to meet the demands of markets that are inherently international” (Oviatt & McDougall, 1994, p. 3).

Prior international experience by founders for new ventures and the effective use of technology together encourage decision-makers for small new ventures to engage competitively in international markets when combined with low cost international transportation and uniqueness of an offering to the marketplace (Oviatt & McDougall, 1994). Consistent with the tenets of internationalization included in stage theory, market knowledge is a necessary element for international expansion. Founders for new international ventures may launch the venture already equipped with necessary international market knowledge, having acquired such experiential knowledge of foreign markets through heritage, travel opportunities, studying abroad, or international exposure in prior work experience.

New international ventures may be examples of how market knowledge may be *added to* following the founding of the enterprise, rather than the organization beginning from a deficit of foreign market knowledge, as is normally observed in stage-theory internationalization. New venture entrepreneurs may have the needed market insight and design the venture for international engagement when founding the firm. The international new venture avoids routines of organizing a firm exclusively in a domestic economy and developing foreign-market knowledge following the launch (Oviatt & McDougall, 1994).

Born Global

New international firms designed by their founders to utilize knowledge-based resources to sell outputs in multiple countries are referred to as *born global* (Knight & Cavusgil, 2004). A global mindset held by the entrepreneurial leaders of the new firm incorporates the idea of serving international markets and is an important force for internationalization of the firm (Miocevic & Crnjak-Karanovic, 2010). “The distinguishing feature of these firms is their origins are international, as demonstrated by management’s global focus and the commitment of specific resources to international activities” (Knight & Cavusgil, 2004, p. 124).

Rennie (1993) first introduced the notion to recognize the rising importance of small firms to total export sales. Rennie observed from collected data the reversal in the declining contribution to total exports produced by small enterprises. A declining contribution by small firms was the norm during decades of global expansion by large multi-national enterprises (Rennie, 1993). The scale and capital advantages of large enterprises that produce standard products at low cost are also impediments wherein speed, nimbleness, and the ability to address small markets are required; small firms operate with speed, responding with quality products to niche markets defined by consumer tastes for custom and specialized goods (Jamali, Jawad, Shaikh, Shaikh, & Afridi, 2011).

Electronic access to information and the low cost to transfer both data and goods has opened to enterprises of all sizes access to new markets, even allowing smaller firms to compete with large enterprises on equal footing (Kumar, 2012). The lower cost of international business opened the possibility for the formation of born-global enterprises that begin small and grow rapidly (Knight & Cavusgil, 2005). Nimble small enterprises are effective competitors providing quality and value that closely match the needs of a highly differentiated customer. Interest in highly specialized niche markets is a phenomenon that differs from the past-dominant practice of horizontal marketing (Rennie, 1993; Smith, 1956).

Members of born-global firms make generous use of electronic communication technology to gain knowledge about foreign markets, to transmit information, and to conduct commercial exchanges (Knight & Cavusgil, 2005). The exploratory, sequential, mixed-methods study conducted by Knight and Cavusgil (2005) discovered organizational attributes that are most associated with international performance: a) international entrepreneurial orientation, b) technological leadership, and c) enterprise differentiation. A study comparing data from 400 Norwegian and French SMEs correlated further these conclusions (Moen, 2002). Smaller firms constrained by available resources and personnel limitations performed best by adoption of an international orientation early in the history of the firm, focus on a narrow market segment, and by providing a differentiated offering to the markets served (Knight & Cavusgil, 2005).

Barriers and Economic Incentives that Influence Leader Decisions

Conclusions drawn from the results of a mixed-methods study of the internationalization experiences of South Carolina leaders supported historical findings reported in scholarly literature (Beall, 2013). Specific and distinct economic incentives motivated enterprise leaders to expand international commerce. Similarly, leaders reported distinct barriers that frustrate successful internationalization of the firm.

Economic Incentives to Internationalize

Economic incentives to internationalize include foreign market opportunity, access to foreign suppliers, competitive threat, declining domestic demand, exploiting a particular uniqueness, and utilization of excess capacity (Bartlett & Beamish, 2011; Bowonder, Dambal, Kumar, & Shirodkar, 2010; Calof & Beamish, 1994; Cavusgil, 1984). South Carolina leaders of small and medium-sized enterprises that view their firms to be international strongly consider foreign-market opportunity and expanded supply chain options from foreign suppliers to be incentives to internationalize (Beall, 2013). The data collected in the study recorded a strongly favorable view expressed by participant leaders that international commerce influenced the success of their firms (Beall, 2013).

Data collected in the study support the conclusion that the rate of growth for South Carolina enterprises that are international exceeds the rate of growth for domestic-only firms (Beall, 2013). The international South Carolina SMEs studied had larger numbers of full-time employees, a higher rate of revenue growth, serve a larger number of customers each year, and operate in a more intensely competitive environment (Beall, 2013). This outcome from the study aligns with earlier recorded findings by Spence, Orser, and Riding (2011) that show organizational metrics for international enterprises are higher than domestic peers.

Internationalization may be an inevitable step in the enduring success of an enterprise designed for competition in a global milieu (Antonie & Feder, 2009). Economic globalization is an observed dynamic that results in increased competition from domestic and international rivals offering access to comparable quality goods (Sinha et al., 2011). Economic incentives for leaders to engage in international commerce have been described as proactive or push drivers and reactive or pull drivers (Vasquez & Doloriert, 2011). Export activity may be grouped by proactive, market-seeking or reactive, and client-following motivated actions (K. London, 2010). External incentives include perceived demand, declining domestic demand, and potential for reductions in supply chain costs. Internal incentives include excess capacity, the need to protect competitive advantages, and the desire to exploit a particular uniqueness.

Developing global economies are neither behind those of developed economies, nor converging into a homogenous pattern; rather, marketplaces throughout the world represent potential opportunity for the international entrepreneur (Bhattacharya & Michael, 2008). International markets are sources of potential demand beyond what is available in a domestic marketplace. Potential new markets may provide the expanding company opportunity for leaders to improve the financial position of the firm, create competitive advantage, more fully utilize capacity, and build management skills (Arteaga-Ortiz & Fernández-Ortiz, 2010).

Barriers to Internationalization

Barriers reported in scholarly literature include leader inexperience, resource scarcity, high costs to accumulate knowledge, expropriation risks, domestic market opportunity, and disadvantages of size, newness, and foreignness (Arteaga-Ortiz & Fernández-Ortiz, 2010; Chelliah, Sulaiman, & Munusamy, 2011; Hutchinson, Fleck, & Lloyd-Reason, 2009; Hynes, 2010; Knight & Cavusgil, 2005; Lu & Beamish, 2006; Sommer, 2010).

Leaders of SMEs in particular face challenges to internationalization due to the disadvantages of smallness, inexperience, foreignness, and newness (Korsakienė & Tvaronavičienė, 2012). Domestic opportunity, leader characteristics, and poverty of resources are barriers to international entrepreneurship. Unique barriers that present challenges not faced by smaller enterprises in domestic markets offset potential opportunities and incremental value creation from international expansion (Miocevic & Crnjak-Karanovic, 2010).

Data in the study of South Carolina firms supported the view of participant leaders that ample domestic opportunity is a barrier to internationalization (Beall, 2013). South Carolina leaders consider domestic opportunity in the local region and across the United States is sufficiently large. Consequently, domestically-focused firms do not pursue foreign markets. SMEs leaders in the study that viewed their firm to be domestic-only did not consider lack of knowledge of foreign markets or resource scarcity to be barriers (Beall, 2013). The leaders of domestic-focused South Carolina enterprises simply did not consider foreign markets as important to their success (Beall, 2013). The low level of perceived importance of the international markets may explain the leader perception that resources and foreign-market knowledge do not present internationalization barriers. A potential explanation of this inconsistency with the literature is that leaders of enterprises with a domestic focus fail to consider additional barriers because they have not investigated requirements for foreign-market entry.

Implications

Open international markets represent historically unprecedented opportunity for small and medium-sized businesses (Kamakura et al., 2012). Once limited to large, resource rich firms, international commerce is accessible to enterprises of all sizes with the organizational will to expand overseas (Oviatt & McDougall, 2005). Action by decision-makers to reach the benefits of internationalization is constrained by a poverty of knowledge of economic incentives and barriers. Only a single digit percentage of SMEs in the United States are exporters, half the internationally active level of SMEs in other developed world economies and a potential cause for economic underperformance by smaller American firms (Tesfayohannes & Habegger, 2011). The gap in what is known of internationalization by SME leaders in general is significantly limiting for leaders of smaller firms.

Such uncertainty reflects a challenge to the entrepreneurial proclivity of the firm, affects deployment of resources, impedes communication, discounts the need to align the organizational supply chain, and deters needed capital infusion (Zhou, Barnes, & Lu, 2010). The globalization phenomenon of world markets is a persistent trend that is accelerating, and leaders perceive growing global markets as increased opportunities for smaller enterprises to participate in international commerce (Ibeh, Carter, Poff, & Hamill, 2008). Limited understanding by leaders of the incentives linked to international success and techniques effective for overcoming barriers may restrict smaller firms from rewarding involvement in international markets.

Economic incentives that are motivations for leader decisions to expand company involvement into international commerce include proactive market-seeking opportunity and reactive client-following or competitor-matching responses (K. London, 2010). Barriers that impede international expansion include poor organizational readiness, limited enterprise resources, leader inexperience, limited knowledge of foreign markets, and competing domestic opportunity (Hynes, 2010; Korsakienė & Tvaronavičienė, 2012; Rodrigues & Child, 2012). Decision-makers who contemplate international expansion may do so in response to opportunity, the urging of customers, as a reaction to competitor initiatives, following market momentum, or as a reply to numerous business threats (Hynes, 2010; McMullen, Shepherd, & Patzelt, 2009; Nkongolo-Bakenda et al., 2010). Entrepreneurial hubris is a contributing factor in enterprise failure due to an overestimation by leaders of the likelihood of success; yet leaders naively initiate new ventures with enthusiasm (Hayward, Shepherd, & Griffin, 2006). Leaders of smaller enterprises benefit from information useful to identify economic incentives linked to a likelihood of success. Leaders benefit as well from knowledge of barriers that are disincentives to international expansion.

Conclusion

The increasingly global nature of commerce is an important business dynamic recognized by enterprise leaders and scholars (Bartlett and Ghoshal, 2002; Hames, 2007; Ibeh, Carter, Poff, & Hamill, 2008). Leaders who may not embrace foreign commerce may be less aware of the potential threat or opportunity represented by cross-border trade. The United States economy is large, providing considerable opportunity that was shown to be a barrier to internationalization by some business leaders (Beall, 2013). Leader opinions studied in a verity of research projects support the conclusion that decision-makers in positions of responsibility for enterprises that are international feel international activity important to the success of the enterprise. Leaders who experience international business understand the importance of foreign-market commerce, the potential risks, and the international opportunity available to businesses of all sizes.

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