

Economic Internationalization Potential of SMEs in the BSR

- Comparative Analysis

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Abstract

Due to globalization and liberalization of international markets, the degree of international business orientation is constantly increasing nowadays. However, this ongoing process of internationalization represents not only opportunities, but as well as risks and challenges especially for small and medium-sized enterprises (hereafter: SMEs). Although having real chances and potential to play on international market stage, many companies stay still national and home market oriented. Some firms view even the process of integration and liberalization of markets not as an invitation for international business, but as a threat for their own existence.

Compared to large companies SMEs are known to have their internal structural obstructions e.g. in the form of limited financial and human resources. And the idea of international activities is often rejected without considering their advantages or professional evaluation of firm's internationalization potential.

The paper aims at exposing functional areas of concern that prevent SMEs from going international. Furthermore, an effort is undertaken to give a rough comparative evaluation of economic internationalization potential of SMEs in the Baltic Sea Region countries.

Introduction

Establishment, its further support and development of private sector, seen here as SMEs, is traditionally one of the key elements and principal driving forces of the political, social and economic development of any industrial country. SMEs stimulate private ownership, promote innovations and entrepreneurial skills, they contribute significantly to export / import activities, employment and general welfare of a country's economy. Their advantageous flexibility enables them to adapt to quick changing demands of domestic and international markets. In fact, the SME sector represents the backbone of the economy and society in Europe. More than 99% of all EU companies are SMEs having up to 250 employees. SME sector offers 66% of all jobs in the European Union and is responsible for 55% of the EU value added. SMEs are operating in all main business sectors: craftsmanship, industry, trade, tourism, IT and services. Firms' structure in the BSR is predominated by SMEs, especially in the EU-members from Eastern Europe.

But in spite of their indispensable role, SME sector can be regarded as underdeveloped in the new EU countries and in certain regions of old EU members in the BSR. *De facto*: the majority of companies are still more national and home market oriented, which especially applies to SME's. The whole SME sector experiences problems to benefit from the advantages of the new EU-market due to their usually underdeveloped intercultural experiences and their lacking knowledge about the European business structures. Certain SMEs, possessing real potential to succeed on international markets are staying national. Moreover, some firms view even the process of integration and liberalization of markets not as an invitation for international business, but as a threat for their own business existence.

Alone recognizing a profound attractiveness of foreign market opportunities is in a rule not enough for a small company to enter a new market. Very often it is not the objectives factors like lack of financial or human resource, but a subjective assurance and a fear to fail that hinder them to go international.

This paper aims at exposing functional areas of concern that prevent SMEs from going international. Furthermore, an effort is undertaken to give a rough comparative evaluation of economic internationalization potential of SMEs in the Baltic Sea Region countries.

Research area and objectives

The strategic research field, which has obtained more and more attention during last two decades, is here the internationalisation process of SMEs. A series of studies support the idea that size of a company does not have a significant influence on the international competitiveness of a firm and export's volumes seem to be unaffected by a firm size (Beamish and Munro 1986; Edmunds and Khoury 1986; Julien, Joyal, and Deshaies 1994).

But, as it was stated before, small and medium-sized companies often cannot enjoy all the opportunities of the internationalization process, since the majority of SMEs are known to have their certain structural obstruction e.g. in the form of limited financial and human resources. It is, therefore, unrealistic to expect them to follow the internationalization process in the same way as large and mature companies do.

Indeed, considering the German SMEs under the aspect of internationalisation, there are some recent studies revealing big differences in the level of internationalisation depending on the size of the company.

Compared to large companies, SMEs are known to have their internal structural obstructions, for example, in the form of limited financial and human resources. And the idea of international business activities is often rejected without considering their advantages or professional evaluation of the firm's internationalization potential.

Prime questions and objectives of this research are:

- Preliminary assessment of the economic internationalization potential and readiness of SMEs for international business activities. How prepared are SMEs themselves for the international business?
- Exposing the demand side of SMEs, where an effort is undertaken to investigate a range of risks and threats as well as strengths perceived by SMEs in regard to business internationalization process within complex and dynamic economic environment of the Baltic Sea Region.

Secondary objectives:

- Supply side is treated here by examining the extent to which transport and IT infrastructure is developed to create needed conditions and to match the requirements of SMEs.

Business internationalization – considered theories

Uppsala Perspective

The concept of internationalisation of enterprises comes to the force about thirty years ago. Traditional approach could be named here as the *Sequential Theory of Internationalization* or *Uppsala Perspective*. While examining some Swedish firms Johanson and Vahlne (1975) noticed a regular process of gradual change of a company undergoing the process of internationalisation by moving consequently through four discrete stages of so-called establishment chain:

1. intermittent export, imports
2. exports, imports via agents, independent representatives
3. establishment of foreign sales affiliates, licensing, franchising
4. establishment of production facilities, e.g. foreign direct investment

The main assumption of the Sequential theory (developed in 1977) is that each of this stage marks a progressive increase in the resource commitment of an enterprise benefiting from resources originating from other markets. Thus, while moving gradually through all these stages the information and experience base expands correspondingly that enables the progression to the next level much easier. In other words the higher the resource commitment to the foreign markets the smaller the expected risks and uncertainty associated with the expansion of the international activities. In this sense the model is flexible; every reached level enables to determine the possible and recommendable strategy of the further internationalization.

However, nowadays due to the improvement of global communication, transport and IT infrastructures, the companies can internationalize differently and even more dynamic compared to this evolutionary theory [EH].

Network theory

The process of internationalization is seen by the network theory as a foundation of already existing relationships or gaining new by means the old ones. And it is living people and not organisations that making decisions, taking actions and doing business [SW]. Coviello & Munro (1995, 1997) examined internationalization of small and medium-sized software companies also from the network perspective. According to their results the companies were able to internationalize very rapidly because they linked themselves to extensive established networks, and evidently in IT society it is easier to make new contacts and to maintain old ones [MF]. Networks in the perspective of the process of internationalization can be seen at free levels:

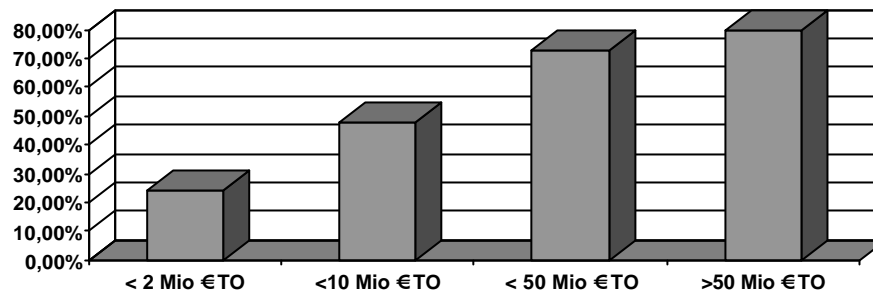
1. *Macro level*: Rather than interplay of political, social and economic issues, network theory is perceived here as a set of various personal interests, powers and preferences that affect national as well as international business decision-makers. In order to start international business operations, a company shall develop new relationships in the target market. A newcomer may see it complicated and even hopeless to make profits in a new market that possesses already functional network of relationships. Consequently, only those companies will be able to succeed on foreign market(s), which are better prepared and able to review and / or restructure their relationships' network; or those that enter new markets with already existing relationships' network in the target market.
2. *Inter-organisational level*: In already existing relationships' network (e.g. suppliers and customers, competitors and collaborator, etc.) in case if one member of a network starts internationalization, which takes the other players along with.
3. *Intra-organizational level* treats relationships' network within a company. The relationships within a firm influence directly the decision making process. Personal relationships of a decision-maker in a company become to business relationships. Or if already internationalized company has subsidiaries abroad, the decisions may be made decentralized directly in a subsidiary, which in a rule increases the degree of international business involvement. Personal business international orientation of single decision-makers plays a significant role here.

Previous regional studies on business internationalization

Regional study on international activities of SME's performed in 2006 by Wismar University and the Chamber of Commerce in Schwerin gave an overview about the situation in the Westmecklenburg region. The survey based on ca. 300 questionnaires, responded by regional manufacturing and service companies [DH, IHK]. Westmecklenburg region is characterized by a dominating SME sector, whereas about 50% of all companies are micro enterprises, having up to 10 employees. And only less than 10% of all regional turnovers are generated by international operations.

The regional survey confirmed that the importance of international activities for a company is increasing proportionally with its size [PK]. Whereas, only less than 25% of all companies with up to two million EUR of total turnover are performing export activities. In the sample of companies with more than 50 million EUR of total turnover - already 80% of the firms are generating export turnovers:

Figure 1: Percentage of companies with export turnover



Source: Anatoli Beifert and Gunnar Prause, International Services for SMEs - An Empiric Analysis, Pages 239 – 257, Baltic Business Development, Szczecin 2006

By analyzing the most important foreign countries which are representing trade partners for the companies in Western Mecklenburg the survey revealed the following picture which is ordered by the size of the annual turnover of the regarded companies (see table Table1):

Table 1: Target countries of World Market enterprises

Country	< 2 M	Country	2-10 M	Country	10-50 M	Country	>50 M
Netherlands	10,65%	Netherlands	7,22%	Denmark	7,22%	Netherlands	1,03%
Denmark	7,90%	Denmark	6,53%	Austria	6,53%	Austria	1,03%
Austria	6,87%	Austria	6,19%	Netherlands	6,19%	Denmark	1,03%
Belgium	6,53%	Belgium	5,50%	Sweden	5,84%	Spain	0,69%
Poland	5,84%	Poland	5,15%	France	5,50%	France	0,69%
Sweden	5,50%	Sweden	4,81%	Belgium	5,50%	Italy	0,69%
France	4,81%	France	4,47%	Poland	5,15%	Poland	0,69%

Source: E. Kron, G. Prause, Improving regional development through Logistics and ICT competence, Pages 351 – 375, Baltic Business Development, Szczecin 2006

Noticeable observation that could be drawn from the table above is that the most important target countries for international business operations are outside of the Baltic Sea Region. Especially, smaller companies prefer for their foreign activities such countries like the Netherlands, Austria and Belgium. One reason for their decision can be found in the good German language skills in countries like the Netherlands, Denmark, Austria and Belgium stressing that the language and intercultural skills are playing an important role in foreign activities.

Another important question examines regional economic links within the BSR. The survey revealed that the BSR is still underrepresented in the perception of the regional

companies. For all regional companies Denmark is the most important target country followed by Poland and Sweden.

The surprising fact that the BSR is getting more unimportant for the larger region companies is connected to the fact that the biggest regional companies are related to the ship building and wood processing clusters, which are linked to costumers outside the BSR:

Table 2: BSR target countries in 2005

Country	< 2 M	Country	2-10 M	Country	10-50 M	Country	>50 M
Denmark	7,90%	Denmark	6,53%	Denmark	7,22%	Denmark	1,03%
Poland	5,84%	Poland	5,15%	Sweden	5,84%	Poland	0,69%
Sweden	5,50%	Sweden	4,81%	Poland	5,15%	Sweden	0,34%
Finland	3,09%	Finland	4,12%	Lithuania	3,78%	Finland	0%
Estonia	1,37%	Estonia	2,06%	Finland	2,75%	Lithuania	0%
Latvia	1,37%	Latvia	1,37%	Latvia	1,72%	Estonia	0%
Lithuania	0,34%	Lithuania	0,69%	Estonia	1,37%	Latvia	0%

Source: E. Kron, G. Prause, Improving regional development through Logistics and ICT competence, Pages 351 – 375, Baltic Business Development, Szczecin 2006

The survey revealed also that regional Chambers of Commerce, business consultants and Research and Development Agencies (RDAs) did not cover demands and needs of SMEs in preparing or supporting international business activities. Due to this lack of support of SMEs the concept for the European research project -Baltic Business Development Network (BBDN) was worked out in order to investigate the real needs of SMEs in the BSR and to help SMEs to start sustainable and successful international activities in the Baltic Sea Region.

BBDN - research project

In the frame of the “INTERREG III B Program” an important EU-project in the frame of the “INTERREG III B Program” started in 2005 with two partner institutions from each Baltic Sea Region country. Under the leadership of Baltic Business School Kalmar the three year project „Baltic Business Development Network“ is focusing on the coordination of regional development in the participating partner countries by founding a virtual regional development agency (Virtual Baltic Development Agency – VBDA). Through the BBDN international business services are offered to the SMEs so that they can benefit from the advantages of the enlarged EU-market. The presented results are based on the empiric work of the BBDN project together with the results of the study on internationalisation.

Research approach

The research approach of the paper is prevailing quantitative, whereas many of the treated issues here are of a qualitative nature. The method used for the acquisition of the raw data was a structured questionnaire consisting of closed questions. During the

research process it turned out that the examined topic demands deeper analysis with qualitative approach to support and supplement gained observations. Therefore, this paper shall serve as a basis for the further investigations.

Supply side is treated here by examining the extent to which transport and IT infrastructure is developed to create needed conditions and to match the requirements of SMEs. The main focus is, however, laid here on the *demand side*, where an effort is undertaken to investigate a range of risks and threats as well as strengths perceived by SMEs in regard to business internationalization process within complex and dynamic economic environment of the Baltic Sea Region. Furthermore, an assessment of the theoretical potential and readiness of SMEs for international business activities is made.

The partner countries of the BBDN project were the subject of the empirical work here: Denmark, Estonia, Finland, Germany, Latvia, Lithuania, Poland, Sweden and Russia (Kaliningrad and St.-Petersburg regions). The survey was executed in the regions of the BBDN partners:

Table 3: Represented regions in the survey

Country	Region
Denmark	Bornholm
Estonia	Tartu region
Finland	South Ostrobothnia region
Germany	Westmecklenburg region
Latvia	Riga region
Lithuania	Vilnius region
Poland	Szczecin region
Sweden	Kalmar region
Russia	Kaliningrad region

Research results

Background information

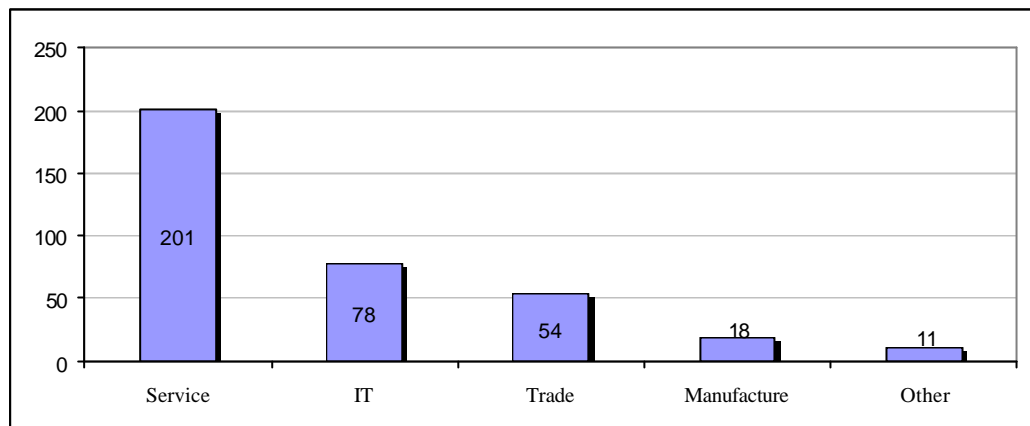
320 regional enterprises from the BSR countries participated in the survey. Questioned firms vary in size of employment from 1 to 259 employees. The division of the questioned companies is as follows:

Table 4: Break down of questioned companies according to their size

Company size	Number of employees	Number of companies	Percentage
Micro enterprises	up to 9	182	56,88 %
Small enterprises	from 10 to 49	104	32,50 %
Medium	from 50 to 249	34	10,63 %

The subdivision of the questioned companies to business sector is as follows:

Figure 2: Break down of questioned companies according to business sector



The subdivision of questioned companies according to business sector could not be identified definitely for some companies classified themselves belonging to different business sectors (e.g. many companies belong to IT and service sector). To “others” belong companies representing Transport or Tourism sector.

Evaluation of current state of transport and IT infrastructure

Supply side is represented here by examining the extent to which transport and IT infrastructure is developed to create needed conditions and to match the requirements of SMEs for their business international operations.

Figure 3: Evaluation of current state of transport infrastructure

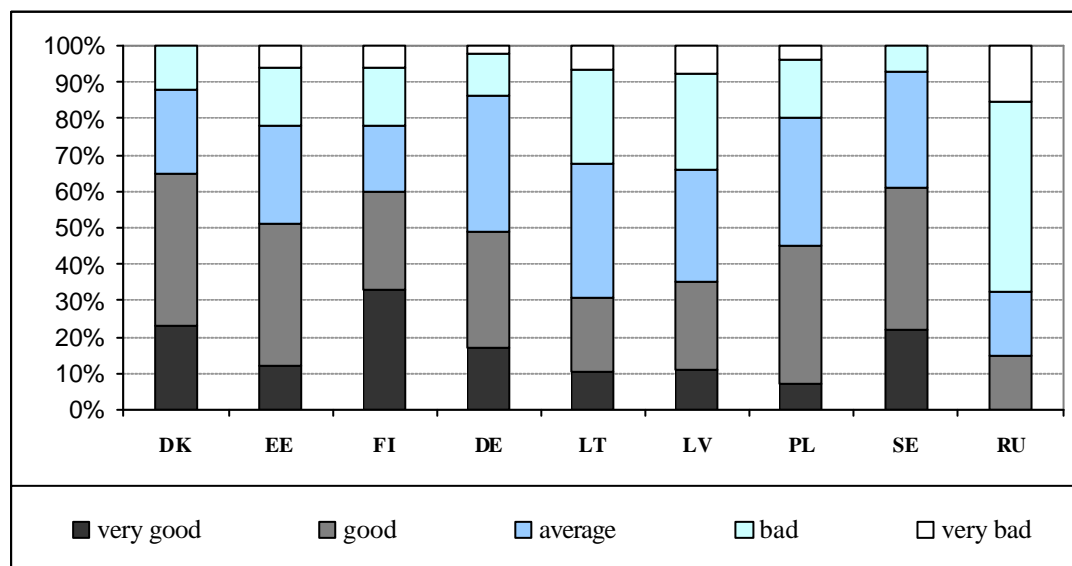
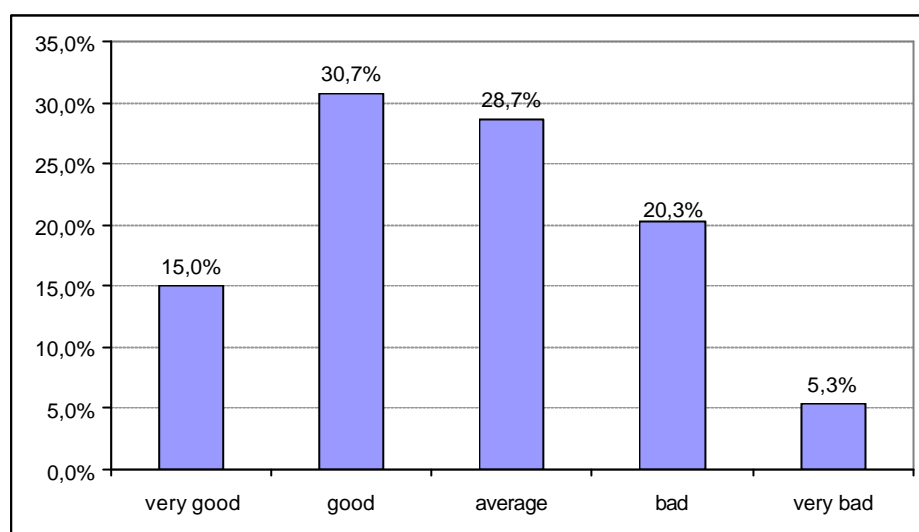


Figure 3 shows responders’ evaluation of the state of transport infrastructure in their regions. Making a differentiation in a comparative analysis of this data between represented regions from “old” EU countries like Denmark, Finland, Germany Sweden and regions from new EU countries including Kaliningrad region from

Russia, it can be mentioned that accumulated average of “very good” and “good” evaluation in the first group is ca. 59% and in the second group is 35%.

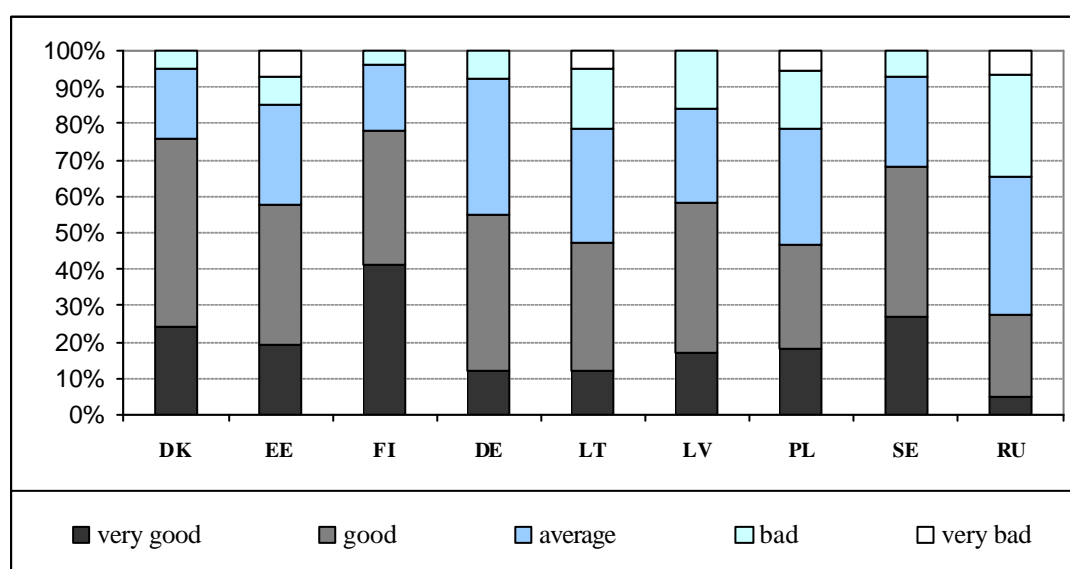
Figure 4: Average evaluation of transport infrastructure in the BSR



A general respondents' evaluation of the transport infrastructure in the participating regions is rather positive. Except of Russia, ca. 47,7% of questioned companies evaluated of the state as “very good” or “good” and 31,0% as “average”, whereas ca. 67,3% of respondents from Kaliningrad evaluated as “bad” or “very bad”.

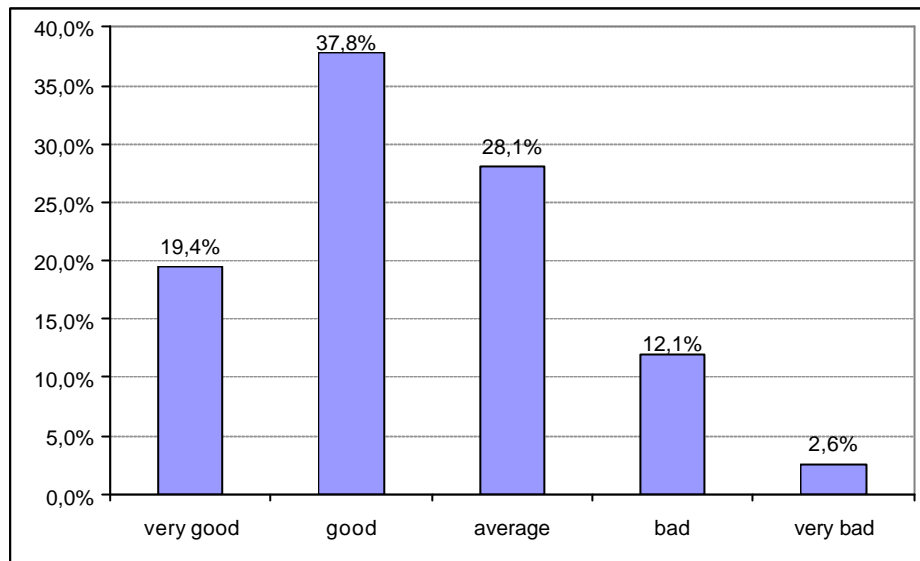
The following figure indicates the responders' evaluation of the IT infrastructure of their regions:

Figure 5: Evaluation of current state of IT infrastructure



Rather positive responders' answers prevailing in the evaluation of the IT infrastructure in the participating regions. 57,2% of questioned companies evaluated of the state as “very good” or “good” and 28,1% as “average”.

Figure 6: Average evaluation of IT infrastructure in the BSR

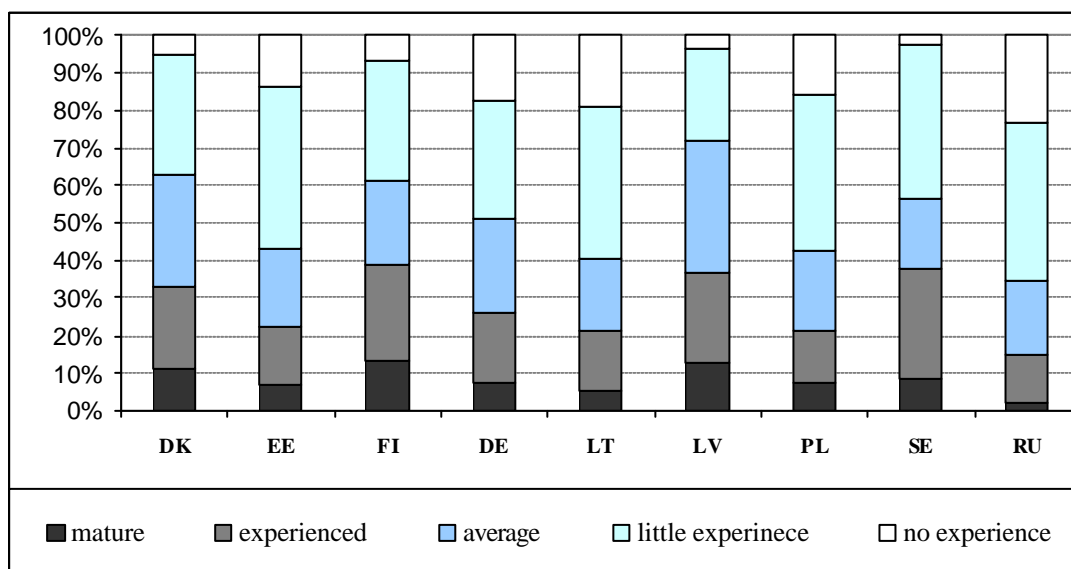


A general interesting notice of these evaluations is that IT companies estimating the state of IT infrastructure in their region mostly named it as “bad” or “very bad”, whereas general evaluation of other companies was positive. The same can be mentioned about Logistics companies – their evaluations about the state of transport infrastructure in their regions were mostly negative.

Evaluation of previous international experience and motivation

The previous international experience of the questioned enterprises in general can be evaluated as not sufficient, mostly concentrating on a direct trade in a rule using their own purchase and/or distribution channels; whereas by ca. 15% of internationalized SMEs, export share amounts about 2/3 of the whole turnover.

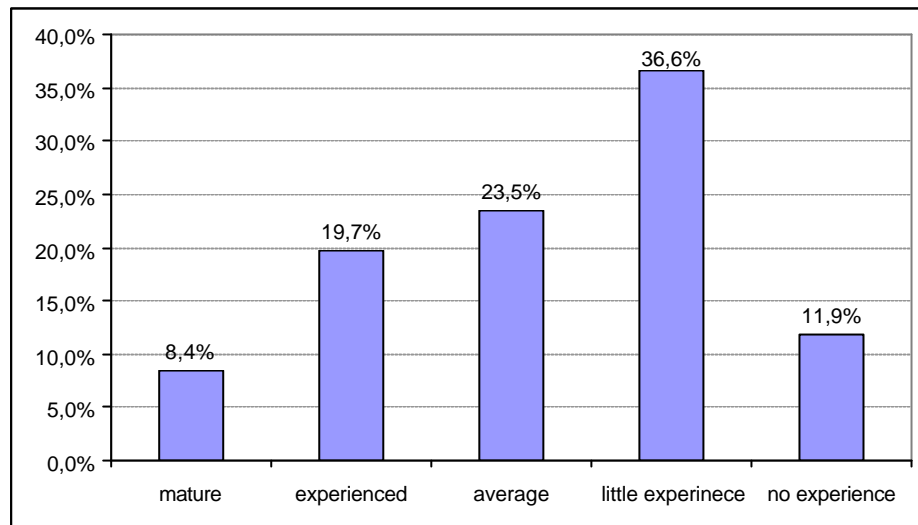
Figure 7: Evaluation of the previous international experience



In average, 28,1% of the questioned companies classified themselves in regard to international business involvement as *mature* or *experienced*. Whereas, Swedish,

Finish and Latvian companies defined themselves as having a little more international experience in comparison with other BSR countries.

Figure 8: Average international experience



Although 88,1% of questioned companies generate or have generated some turnover outside their domestic market, the general picture is that international business involvement of the questioned companies can be regarded as insufficient.

The survey results revealed also that a normal procedure for export / import activities of SMEs implies an attribute of *incrementalism*. International experience of questioned small and medium sized companies may be named as spontaneous. They work adding to their international business activities small and often unplanned extensions, instead of development and implementation of a consequent strategy for market entrance with the definite international orientation.

Thus, SMEs prefer or choose intuitive the stage approach according to Uppsala Perspective, beginning mostly with small international involvement, e.g. import / export activities. It may be explained by the following suggestion. Having limited financial and human resources, small and medium sized companies are interested in the fast profit and normally are not ready to make long-termed investments. In accordance with this theoretical perspective, SMEs may be expected to expand their international business involvement by moving through the stages of the establishment chain, making it possible to forecast their further steps.

In spite 30% of the questioned companies identified themselves as mature or experienced, nevertheless according to international business involvement they can be positioned only on the first stage of the internationalization process of Uppsala Model.

Problems and risks perceived by SMEs in regard to business internationalization

The main idea of this paper is to give a general overview of the problems and risks in order to allow contrasting this data with the responders' own evaluation of their readiness and general potential for the international business activities. Thus, ranking of the most difficult problems perceived by SMEs is not covered here to the full

extent, since more detailed research is required. In this paper the evaluation of the language and cultural problems in the target market as well as general evaluation of risks and threats for a company are represented.

Evaluation of language and intercultural issues

Participating in the survey SMEs were questioned on the matter of the importance of the language and intercultural issues in regard to business internationalization.

Figure 9: Importance of language and intercultural problems

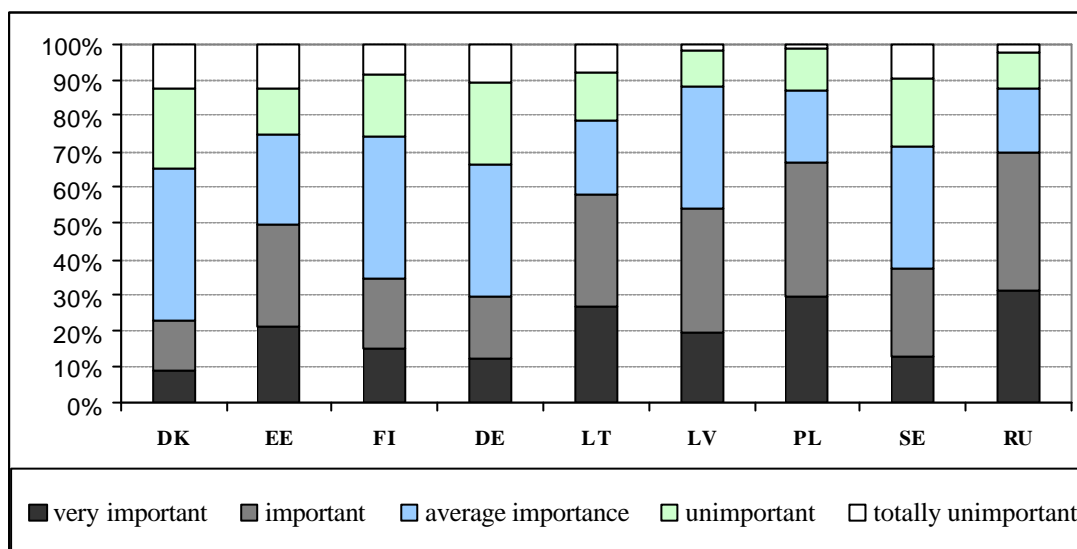


Figure 2 indicates the percentage of the responders from BSR countries identifying the importance of the language and intercultural issues when a company is involved in international business or contemplating to do so. It is evidently to observe two groups of countries. The first one is represents the new EU countries like Estonia, Latvia, Lithuania and Poland as well as Russia, for whom the language and intercultural issues play an important role by the decision-making process for doing international business. And on the contrarily, so-called old BSR countries like Denmark, Finland, Germany and Sweden feel themselves more confident in this field. Another hypothesis that may be drawn from the gained data is that the countries giving a high ranking to language and cultural issues, in their turn will require the same level of respect it from the incoming overseas companies. Following this idea, that may mean that having this current attitude to the language and cultural issues in the sample of respondents, we shall differentiate between three cases:

1. *Homogeneous attitude*: when company(ies) is(are) doing or contemplating international business within above named country groups. E.g. Swedish firm is operating only on Danish, Finish, and German market; or Latvian firm is active in Estonia, Poland and Russia. In this case the cultural theme is treated by the business partners to the same extent.
2. *Overestimation of language and culture*: when company(ies) from the first group is(are) active in the country(ies) from the second group. E.g. a Lithuanian company is active in the German market. In this case the Lithuanian company will overestimate the importance if not of language, than of cultural knowledge of Germany. If it is so, than in its case that assumption

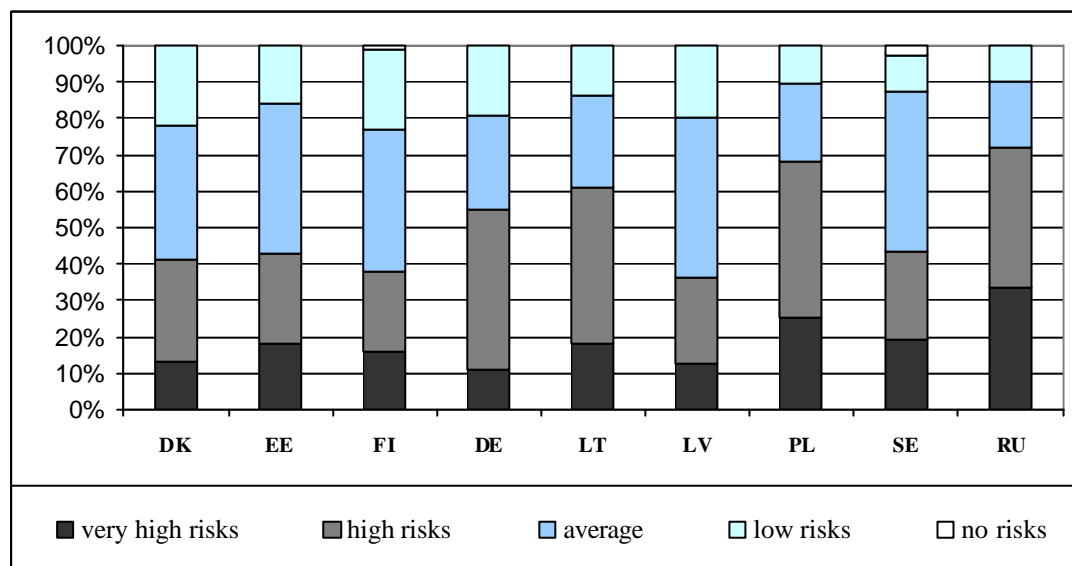
of high importance of language and culture will prevent many companies from first group going international to the countries from the second group.

3. *Underestimation of the language and culture*: when company(ies) from the second group is (are) active in the country(ies) from the first group. E.g. a German company is active on the Russian market. In this case, paying relative low attention to language and culture of Russia may cause some problems if not ruin the whole international business operations in this market. The host country will expect a newcomer to play the game according their *unwritten* rules.

General level of risks and threats

Within the scope of the survey the participating companies were asked to give their own evaluation of the general level of risks and threats in regard to business internationalization.

Figure 10: General level of risks and threats

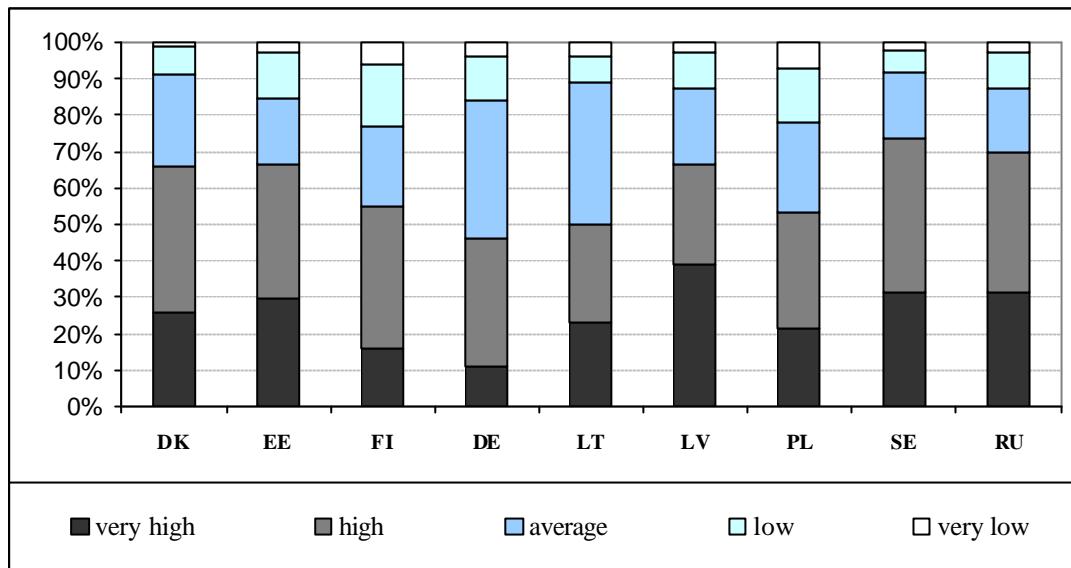


By contrasting the data of the perception of risk and threats with the data from previous international business experience a noticeable finding can be made that in a rule the companies estimate the general level of risks as “very high” or “high” that had / have none or only a little international experience.

Evaluation of motivation and general potential

The following figure shows the responders’ evaluation how motivated they and / or their employees are for international business:

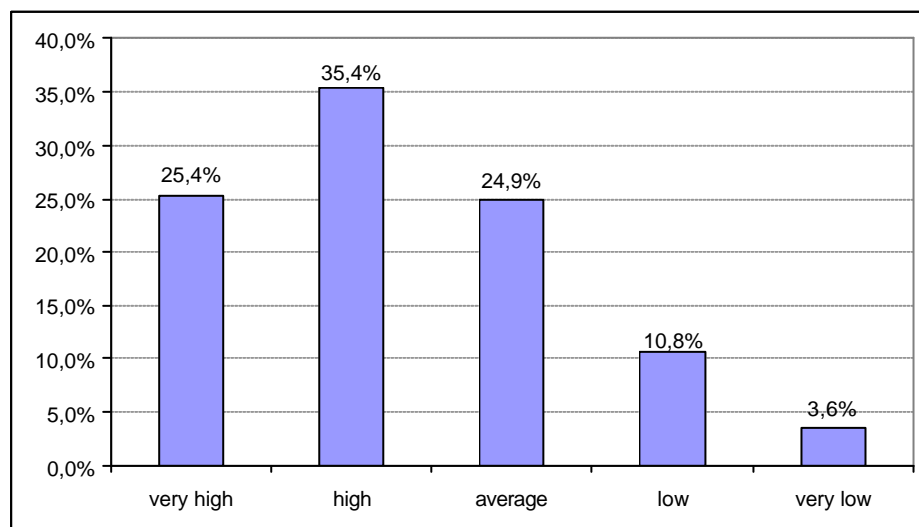
Figure 11: Motivation of managers and staff for international business involvement



By observing international business experience of questioned SMEs, it came out that mostly the contacts are either between countries with similar culture or language (e.g. a Latvian company is mostly active in Lithuania, Estonia or Russia) or between neighbour countries (e.g. between Germany and Poland). Within the framework of that study it was not possible to identify the real reasons for such business connections. A stimulant for international business operations for the decision-makers may be their personal relationships and interests to a certain foreign market.

That suggestion supports the *network theory* that interprets process of business internationalization as a process established on already existing relationships or creating new business and economic relationships by means of old social relationships.

Figure 12: Average Motivation of managers and staff for international business involvement



Ca. 60,7% of all questioned companies identified their motivation in regard to international business activities as “very high” or “high”

That data indicates that in spite of all perceived problems, threats and risks, the majority of SMEs do understand the attractiveness of overseas markets and a preliminary forecast may be made that in the nearest future there will be a significant increase of international business activities performed by SMES in the BSR.

Cross-referencing of this data with the data from previous international business experience (ca. 36,4% named their international involvement as “mature” or “experienced”) and the level of risks (ca. 50,9% of companies estimated them as “very high risks” or “high risks”) - nevertheless ca. 60,7% of questioned companies evaluated their motivation in regard to international business involvement as “very high” or “high”.

Figure 13: Theoretical level of potential for business internationalization

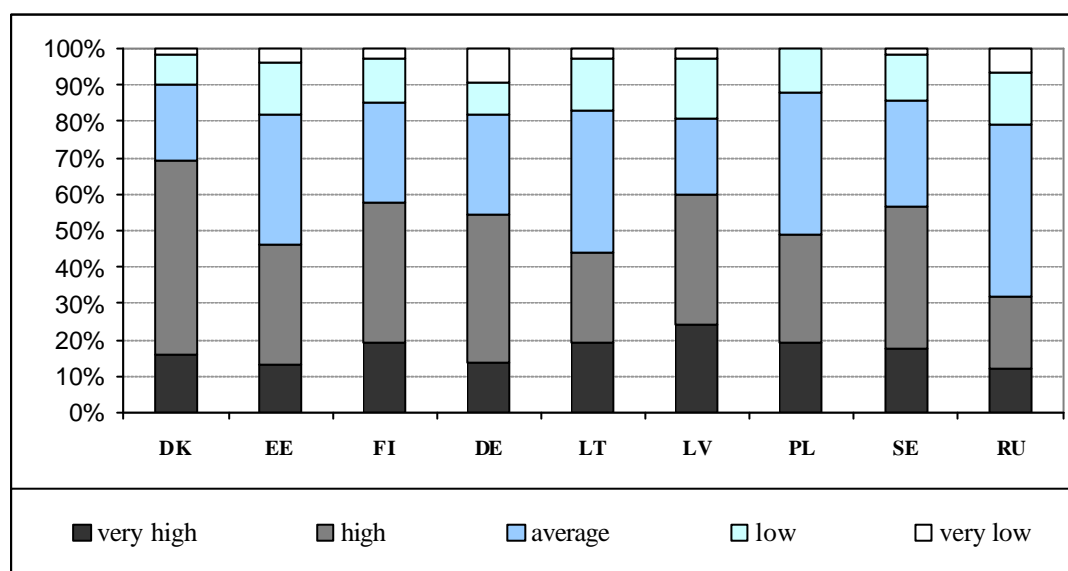


Figure 13 shows the responders’ evaluation of their readiness and general being prepared for international business activities. The question implied also such aspects as hypothetical evaluation of the success of the products and / or services in the target market and theoretical capacity of the firm to increase production.

Summary

The overall aim of this paper was to provide regional policymakers as well SMEs themselves with general information about the level of willingness and readiness of small and medium-sized firms in the BSR for international business activities. Importance of internationalization process for SMEs and its further indispensable growth was underlined.

The results of the survey showed that in spite of all the obstacles and barriers connected with internationalization process, the majority of companies in the BSR possess a relative good motivation and potential to internationalize their business. Having realized this fact and answered these strategic questions positively, it will be only the question of methodology and time when a firm enters a foreign market or increase already existing international involvement.

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