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Internationalization of European SMEs towards Emerging Markets

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ABSTRACT

Emerging markets used to be closed economies that have only recently begun opening up their markets to the world economy. In addition to multinational enterprises (MNEs) small and medium-sized enterprises (SMEs) from developed countries have also started to undertake international activities in emerging markets. This paper investigates whether SMEs from higher-income European countries that operate in emerging markets are different from SMEs that operate exclusively in other developed markets e.g. in terms of their firm characteristics, internationalization motives and perceived internationalization barriers. The empirical analysis uses firm-level data for 3,698 internationally active SMEs located in 19 European countries (i.e. EU-15, Iceland, Liechtenstein, Norway and Switzerland).

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INTRODUCTION

In an increasingly global economy internationalization is more and more part of the current reality of doing business, also for small and medium-sized enterprises (SMEs). Originally, international business was mainly the domain of large multinational enterprises (MNEs). However, SMEs increasingly deal with the trend of globalization. Internationalization of SMEs has expanded due to technological changes (mainly in the area of transportation and communications), deregulation of markets, the liberalization of world trade and the establishment of regional economic cooperation agreements such as the European Union. As compared to larger firms, SMEs are typically more resource-constrained (Fujita, 1995; Coviello & McAuley, 1999; Knight, 2000; Hollenstein, 2005). However, even small, resource-constrained firms can succeed when operating in foreign markets (Knight & Cavusgil, 2004; Oviatt & McDougall, 1994) and are able to access valuable resources through their international activities (Kuemmerle, 2002). Also, SMEs from developed countries have started to undertake international activities in (more) risky country environments such as emerging markets.

An important development of the past decades is emerging markets' increasingly important role in the world economy. An increasing amount of world investment has shifted towards emerging markets. As most emerging economies have only recently begun to open up to the world economy, there are many unexploited international opportunities for firms located in these markets. Also, conditions that are specific to emerging market environments may provide firms that are based in these markets, including foreign firms, with competitive advantages e.g. resulting from low production costs and availability of cheap labor. Firms (including foreign firms) may also take advantage of sales opportunities resulting from rapidly growing income levels per capita in emerging markets.

Despite the increasing important role of emerging countries in the world economy, research attention for SMEs and entrepreneurship in relation to emerging markets is still limited (Bruton et al., 2008), including attention for the type of firms that undertake activities in emerging markets. The current paper focuses on SMEs from mature markets that undertake international activities in emerging markets. In particular it is investigated whether SMEs from higher-income European countries (i.e. SMEs from EU-15 countries and Iceland, Liechtenstein, Norway and Switzerland) that operate in emerging markets are different from SMEs that operate exclusively in other developed markets. We argue that SMEs from developed countries that undertake international activities in emerging markets are likely to have greater resource bases, more often face barriers when internationalizing and tend to have different internationalization motives than SMEs that are internationally involved in other developed nations only. The empirical analysis uses firm-level data from the ENSR Enterprise Survey 2003 for a large sample of SMEs located in 19 European countries (EU-15, Iceland, Liechtenstein, Norway and Switzerland).

The paper is organized as follows. First, the literature and theoretical background are discussed. The subsequent sections elaborate on the data and methodology that are used and present the empirical results. Finally, the findings are discussed and interpreted and some implications for research and policy are formulated.

LITERATURE AND THEORETICAL BACKGROUND

Because of developments such as globalization and advancements in information technology much of higher-income European economies have shifted economic activity from traditional industries (such as automobile production, textile and machine tools) towards knowledge-based industries. These developments have resulted in a more important role for small and new firms in developed economies. Consumers increasingly demand tailor-made and personalized products instead of mass-produced goods, thus providing many opportunities for small firms to target specific niche markets. This marks the shift from a managed to an entrepreneurial economy that developed economies have experienced in the past decades (Audretsch & Thurik, 2000, 2004). In the current economy, many of the traditional barriers to internationalization have been reduced for SMEs. It has become easier to find information about foreign clients and foreign market conditions and resources. Meanwhile, resources such as knowledge and labor have become more mobile and more easily transferable between countries (Autio, 2005; Sapienza et al., 2006). Consequently, internationalization has become a more feasible option even for resource-constrained SMEs and SMEs from developed countries have also begun to undertake activities and exploit opportunities in (more) risky country environments such as emerging markets.

Emerging economies are low income countries with relatively low levels of GDP per Capita that experience rapid economic growth. In this paper we make the assumption that emerging economies differ from mature economies e.g. in terms of institutional development, nature of opportunities, national factor endowments, dynamism, uncertainty and volatility. Although there may clearly be large variation between individual emerging market countries, these markets share various similarities. These economies are making a transition towards market economies which is associated with processes of market liberalization and privatization. There is a lot of internal turbulence in these countries resulting from restructuring and privatization processes. Also, institutional change is characteristic for emerging market environments, as governments in these countries continually design, revise and implement new policies. Overall, economic and political conditions tend to be more volatile than in advanced industrialized markets (Modey, 2004). Emerging markets have only fairly recently opened up their markets to the world economy. Foreign firms are now increasingly operating in emerging markets, which also contributes to these economies being highly turbulent. Furthermore, the population in transition economies is rather highly educated and there are possibilities for cheap high value added production. Emerging markets, as compared to mature markets, tend to be characterized by various institutional constraints such as a lack of protection of property rights, non-transparent judicial systems, poor enforcement of commercial law and also by political instability, regulatory changes and corruption in the public sector (Luo and Tung, 2007).

Resulting from these specific emerging market characteristics there may be many opportunities for foreign firms, including SMEs, in emerging markets, e.g. for cheap production or for expanding sales of their products and services. Given the risk and uncertainty that may be accompanied with operating in emerging markets one could expect that SMEs from developed economies that operate in emerging markets have a greater resource base than SMEs from developed countries that operate in more similar country environments. Firm resources can refer to both tangible and intangible factors (such as assets, capabilities and knowledge) that are owned and controlled by a firm (Barney, 1991; Ruzzier, Hisrich & Antoncic, 2006). According to the resource-based view competitive advantage is generated by a firm's valuable, unique resources (Barney, 1991; Penrose, 1959; Wernerfelt, 1984). Firms are viewed as being heterogeneous in terms of their resource endowments and such resource heterogeneity is essential for explaining differences in the performance of individual firms. The resource-based view has been applied in previous research to investigate the impact of a firm's internal resource base on the internationalization behavior of SMEs (Bloodgood et al., 1996; Westhead et al., 2001; Zahra et al., 2003). In this paper we apply this view to understanding SME's international involvement in emerging markets. Furthermore, the specific emerging market characteristics lead us to suspect that internationalization motives may differ for SMEs being active in emerging markets and SMEs being internationally active in higher-income environments only. Firms may have different motives for their international activity and may for example internationalize to generate financial resources (e.g. through export sales) or to access know how and advanced technology (Edmunds & Khoury, 1986; Daniels & Bracker, 1989; Zahra et al., 1997; Zahra et al., 2000). Possibly emerging markets will be particularly relevant for accessing specific resources such as cheap labor or for targeting a large customer base, while developed markets may be more appropriate for accessing advanced knowledge and technologies. In addition, SMEs from higher-income countries that operate in emerging markets are also more likely to face barriers resulting from e.g. institutional constraints than in higher-income environments with high quality institutions. The risks and uncertainties associated with operating in emerging market environments may also put pressure on a firm's internal resource base and therefore may result in a higher level of perceived internal barriers. The differences in resource profiles, internationalization motives and perceived internationalization barriers that we expect to exist between European SMEs being active in emerging market contexts and those being active in developed country contexts only may also eventually affect the impact that internationalization has on the firm's competitive strength.

METHODOLOGY AND DATA

We test whether SMEs from higher-income European countries that undertake activities in emerging markets have different resource profiles, face different barriers and may have different internationalization motives than SMEs that are internationally involved in other developed nations only. To test this we use a sample of 7,837 SMEs (firms with up to 250 employees) from the following 19 European countries: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Liechtenstein, Luxembourg, Netherlands, Norway, Portugal, Spain, Sweden, Switzerland and the United Kingdom. Information was obtained from the SME owner/managers through a large-scale telephone survey (ENSR Enterprise Survey) held in 2003 as part of the Observatory of European SMEs for the European Commission.

VARIABLES

International involvement in emerging markets
For the purpose of the analysis we only look at SMEs that are internationally active, defined as firms that have foreign suppliers, and/or are involved in exports and/or have foreign direct investment activities (i.e. having branches, subsidiaries and/or joint ventures abroad). When the European SMEs in our sample are involved in one or more emerging markets they are classified as 1 and otherwise as 0. The following countries in which SMEs in our sample indicated to be internationally active are classified as emerging markets: Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia and Turkey. Non-emerging markets in which the SMEs in our sample mentioned to be internationally active are: Austria, Belgium, Cyprus, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Japan, Liechtenstein, Luxembourg, Malta, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland United Kingdom and the United States. Internationally active firms for whom the owner/manager indicated not to know in which country the firm is involved have been excluded from the analysis (n=264). This results in a final sample of 3,698 firms. Of the final sample 374 firms are involved in emerging markets and 3,324 firms are internationally involved in developed markets exclusively.

Country of origin
Country dummies are constructed for the countries of origin of the SMEs in the sample: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Liechtenstein, Luxembourg, Netherlands, Norway, Portugal, Spain, Sweden, Switzerland and the UK.

Firm size
This variable is expressed in number of employees. We make a distinction between micro (0-9 employees), small (10-49 employees) and medium-sized firms (50-249 employees).

Firm age
This variable pertains to the number of years that the firm has been in operation (as assessed by the owner/manager) at the time of the survey. We make a distinction between firms which have been in operation for ten years of less and firms that have existed for more then ten years.

Turnover increase
When the turnover of the enterprise increased in 2002 as compared to 2001 this variable is coded 1 and otherwise (i.e. when the turnover has remained stable or decreased) it is coded 0.

Industry dummies
Industry dummies are constructed for the following industries: manufacturing, construction, wholesale, retail, transport & communication, business services and personal services.

Internationalization motives
Various dummy variables are constructed for the following motives for the internationalization of the business: access to new and larger markets for your products or services; access to labor; additional production capacity; access to capital; access to know how and technology; the high production costs in the domestic market; strict laws and regulations on the domestic market.

In the survey the owner/managers were asked to indicate how important each of these motives was for the internationalization of their business. When the owner/manager indicated that a motive was 'very important' or 'important' his firm was classified as 1 for each of these motives and otherwise classified as zero. Note that the owner/managers were able to indicate for all these motives (and thus for more than one motive) whether these were important/not important for the internationalization of their business.

Internationalization barriers

Various dummy variables are constructed for external internationalization barriers (i.e. lack of information, lack of support and advice, existing laws and regulations, cultural and language differences, lack of capital or finance) and internal internationalization barriers (i.e. insufficient skills or competence of staff, quality and or specifications of your products and services, high costs of the internationalization process, price of your products or services). Owner/managers had to indicate for all of these potential barriers whether these had made the internationalization process difficult for their firm. When they indicated this to be the case the dummy gets the value 1.

Internationalization and competitive strength

In the survey owner/managers of the internationally active SMEs were asked to indicate whether they felt that internationalizing had improved the competitive strength of their enterprise. When the owner/manager indicated that internationalization improved the competitive strength of their firm this variable gets the value 1 (and otherwise it gets the value 0).

EMPIRICAL ANALYSIS

Home countries of internationally active SMEs and entry mode characteristics

Of the 3,698 internationally active SMEs in our sample 9% (i.e. 374 firms) are active in (an) emerging market(s) and 91% (i.e. 3,324 firms) are exclusively internationally active in one or more other developed countries. We use chi-square tests to investigate whether significant differences exist between both groups of internationally active firms.

Internationally active SMEs from Austria, Denmark, Finland and Germany are significantly more often involved in (an) emerging market(s) than (exclusively) in other developed countries. Conversely, internationally active SMEs from France, Iceland, Ireland, Luxembourg, Portugal, Spain, Switzerland and the UK are less likely to operate in emerging markets. For Belgium, Greece, Italy, Liechtenstein, the Netherlands, Norway and Sweden, there is no significant difference.

Various conditions may affect entry mode choice in emerging markets, e.g. availability of resources including skills and managerial expertise (Meyer and Estrin, 2001), but also other conditions such as property rights protection. Overall, 15% of the internationally active firms in our sample have branches, subsidiaries and/or joint ventures abroad, 85% have import activities, and 56% are involved in exports. SMEs active in emerging markets are significantly more often exporting (77% versus 54%; $p \leq 0.01$) and more often involved in foreign direct investment activities (i.e. having branches/subsidiaries/joint ventures abroad) (27% versus 13%; $p \leq 0.01$) than SMEs that are internationally active in other developed countries only. There are no differences when it comes to involvement in import activities (85% for both groups). In sum, a significantly larger share of internationally active SMEs that operate in emerging markets are exporting and involved in foreign direct investment activities than those being active in other developed markets only.

Basic firm characteristics

Table 1 presents some firm characteristics for the two groups of internationally active SMEs in terms of firm size, industry and turnover development.

-------- Insert Table 1 about here ----------

It appears that SMEs that operate in emerging markets tend to be larger. 34% of the SMEs that have international activities in emerging markets are micro-firms, while this applies to 45% of the SMEs that have international activities in other developed countries only. 32% have 10-49 employees, while this is 29% for SMEs having only activities in other developed markets. 34% of the SMEs that operate in emerging markets are medium-sized, while this applies to 27% of the SMEs that operate (exclusively) in other developed markets. Chi-square tests reveal that SMEs that are internationally active in emerging markets are significantly less often micro-firms, i.e. having 0-9 employees ($p \leq 0.01$) than firms operating (exclusively) in other developed countries, and significantly more often medium-sized ($p \leq 0.01$), i.e. having 50-249 employees.

Also, chi-square tests show that SMEs that are internationally active in emerging markets tend to be older as they less often have been in operation for ten years or less ($p \leq 0.05$) than SMEs that operate exclusively in mature economies.

Regarding industry differences chi-square tests indicate that SMEs that undertake international activities in emerging markets are more often active in manufacturing and wholesale and less often in retail trade and personal services.

For a little less than half of the internationally active SMEs the turnover has increased in 2002 as compared to 2001. Regarding turnover development no differences are found between the two groups of internationally active firms.

The incidence of various internationalization motives

Table 2 indicates the extent to which various motives were important for the internationalization of the business, divided by SMEs being active in emerging markets and SMEs being active in developed countries only.

-------- Insert Table 2 about here ----------

Various motives are significantly more often indicated to be important among SMEs that are internationally active in (an) emerging market(s) than among SMEs being internationally active in other developed countries only. This concerns the following motives: access to new and larger markets for products or services ($p \leq 0.01$), access to labor ($p \leq 0.10$), additional production capacity ($p \leq 0.01$), the high production costs on the domestic market ($p \leq 0.01$) and strict laws and regulations on the domestic market ($p \leq 0.01$). For the motives access to capital and access to know-how and technology there is no difference in the indicated importance for both groups of SMEs. In other words, internationalization is more often used by SMEs being active in emerging markets as a strategy to access new and larger markets for products or services, to access labor, to realize additional production capacity and as a means to escape high production costs and strict laws and regulations in the domestic market.

The incidence of various internationalization barriers and assessment of the impact of internationalization on a firm's competitive strength

Table 3 indicate whether various internal and external barriers have made the internationalization of the business difficult, divided by SMEs being active in emerging markets and SMEs being active in developed countries only.

-------- Insert Table 3 about here ----------

Several barriers that can make the internationalization process more difficult are more often perceived by SMEs that are active in emerging markets than by SMEs that operate in other mature markets. In particular, the following internal barriers are significantly more often perceived by SMEs being active in emerging markets: insufficient skills or competence of staff ($p \leq 0.01$), high costs of the internationalization process ($p \leq 0.01$) and price of the firm's products and services ($p \leq 0.10$). In addition, the following external barriers are significantly more often perceived by SMEs being active in emerging markets: lack of information (($p \leq 0.01$), existing laws and regulations ($p \leq 0.01$), cultural and language differences ($p \leq 0.01$) and lack of capital or finance ($p \leq 0.01$).

Despite this the share of SME owner/managers who indicate that internationalizing their enterprise has improved the competitive strength of their enterprise is significantly higher ($p \leq 0.01$) for firms being active in emerging markets (76% versus 64%).

CONCLUSION, DISCUSSION AND IMPLICATIONS

This paper seeks to investigate whether SMEs from developed European countries that operate in emerging markets differ from those that operate exclusively in other developed countries. Our results illustrate that SMEs that operate in emerging markets differ significantly on several aspects from SMEs that are internationally active in developed markets only. First, they tend to be larger and older, which may reflect that generally SMEs with greater resource bases seek their way into emerging markets. Second, they differ in the extent to which various motives are important for the internationalization of their business. In particular, internationalization is more often used by SMEs being active in emerging markets as a strategy to access new and larger markets for their products or services, to access labor, to realize additional production capacity and as a means to escape high production costs and strict laws and regulations in the domestic market. Third, they more often face specific internal barriers (insufficient skills or competences of staff, the height of the costs of the internationalization process, the height of the prices of the firm's products and services) and external barriers (lack of information, existing laws and regulations, cultural and language differences, lack of capital or finance) in the process of internationalization. Fourth, however, their owner/managers also more often report a positive impact of internationalization on the competitive strength of the firm. The finding that both a higher incidence of barriers and a higher incidence of a positive assessment of the impact of internationalization on the firm's competitive strength is found among SMEs operating in emerging markets is consistent with the view that a high level of risk goes together with the possibility of a high return in emerging markets (Modey, 2004). Overall, these findings provide a further rationale for devoting specific research attention to emerging markets in internationalization research.

The findings of this study have a number of policy implications. First, it is important for SME owner/managers to be aware of the possibility to benefit from operating in emerging markets, e.g. to face lower production costs or to access labor. Policy makers in higher-income European countries could help to increase awareness among resource-constrained SMEs that it can be beneficial to operate in emerging markets. Second, policy makers in higher-income European countries could play an important role in taking away barriers for undertaking international activities for SMEs to operate in emerging markets e.g. by providing (more) information and advice on operating in these markets and by developing specific support programs. Some countries have already developed specific initiatives regarding internationalization of local firms towards emerging markets.

This study is subject to a number of limitations. First, we have treated emerging markets as a homogeneous group, while substantial differences may exist between individual countries, e.g. in terms of institutional environments and levels of economic development and corruption. While we do find indications that it is relevant to distinguish emerging market economies as a whole from mature markets - which may indicate that emerging economies are viewed as unique environments by SME owner/managers from mature economies - future research could also seek to differentiate among (goups of) emerging markets. Second, we have no information on the past internationalization pattern of the internationally active SMEs in our sample. Therefore we could not test whether SMEs that have more experience in doing international business are more likely to undertake international business activities in emerging country environments. Future research could take account past internationalization patterns. Third, we have no information on how SMEs from higher-income countries operating in emerging economies affect the local economy, e.g. in terms of competition and spillover effects and future research could pay specific attention to this.

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Table 1 Firm characteristics, percentage of internationally active SMEs

	Internationally active in emerging market (s)(n=374)	Internationally active in developed market(s) only (n=3324)	Signficant difference? (chi-square tests)
Firm size			
Micro (0-9)	34%	45%	Yes (p≤0.01)
Small (10-49)	32%	29%	No
Medium (50-250)	34%	27%	Yes (p≤0.01)
Firm age			
Firm in operation for 0-10 years	20%	25%	Yes (p≤0.05)
Industry			
Manufacturing	27%	22%	Yes (p≤0.01)
Construction	8%	10%	No
Wholesale trade	25%	18%	Yes (p≤0.01)
Retail trade	12%	18%	Yes (p≤0.01)
Transport and communication	10%	10%	No
Business services	12%	12%	No
Personal services	6%	11%	Yes (p≤0.01)
Turnover development			
Turnover increased in 2002 as compared to 2001	47%	46%	No

Table 2 Internationalization motives indicated to be important for the internationalization of the business (more than one answer allowed), percentage of internationally active SMEs

	Internationally active in emerging market(s) (n=374)	Internationally active in developed market(s) only (n=3324)	Signficant difference? (chi-square tests)
Motives for the internationalization of the business			
Access to new and larger markets for your products or services	81%	68%	Yes ($p \leq 0.01$)
Access to labor	32%	28%	Yes ($p \leq 0.10$)
Additional production capacity	51%	41%	Yes ($p \leq 0.01$)
Access to capital	29%	29%	No
Access to know-how and technology	52%	54%	No
The high production costs on the domestic market	59%	46%	Yes ($p \leq 0.01$)
Strict laws and regulations on the domestic market	49%	40%	Yes ($p \leq 0.01$)

Table 3 Perceived internal and external barriers that made the internationalization of the business difficult (more than one answer allowed), percentage of internationally active SMEs

	Internationally active in emerging market(s) (n=374)	Internationally active in developed markets only (n=3324)	Signficant difference? (chi-square tests)
Perceived internal barriers			
Insufficient skills or competence of staff	16%	11%	Yes (p≤0.01)
Quality and/or specifications of your products and services	13%	10%	No
High costs of the internationalization process	31%	21%	Yes (p≤0.01)
Price of your products and services	22%	18%	Yes (p≤0.10)
Others	9%	8%	No
No internal barriers	30%	33%	No
Perceived external barriers			
Lack of information	17%	13%	Yes (p≤0.01)
Lack of support and/or advice	16%	14%	No
Existing laws and regulations	38%	20%	Yes (p≤0.01)
Cultural and language differences	22%	13%	Yes (p≤0.01)
Lack of capital or finance	20%	15%	Yes (p≤0.01)
Others	6%	7%	No
No external barriers	23%	31%	Yes (p≤0.01)

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