

1 Global expansion - a strategic necessity for SMEs ?

1.1 Preface

SMEs play an important role in each economy. Some of them even became market leaders from an international perspective.

This stands in stark contrast to the fact, that scientific strategic and marketing research up to date has only rudimentarily covered the field of internationalization of SMEs.

The concept and motivation for this book developed from the starting point, that the field of SME-globalization was not researched in sufficient manner, at least not by far to the degree as for large corporations.

Globalization it can be concluded is neither a trend, nor a fad or an isolated phenomenon. It is an unescapable force. If anticipated and understood, it is a powerful opportunity. If not, it can swiftly destroy businesses and drown careers.

As the “concern to globalization”¹ for SMEs has grown extremely over the recent decade, the demand for extended scientific research on the subject matter increases proportionally. The issue of SME globalization deserves more attention due to the threats and opportunities it exposes and offers SMEs to at the same time.

This book intends to make a contribution to this research gap by means of raising the question whether globalization is feasible and/or necessary for SMEs and identifying suitable strategies for SMEs under the condition to maintain the company’s independence.

As a foundation to this book, a thesis framework was developed that complied with the conventions of scientific research leading to relevant questions and examples.

¹ Concern to globalization ... Globalisierungsbetroffenheit

The personal background and commitment to the subject matter is linked to the global expansion of an Austrian SME since 1995. At projects starting point, the relevant company was doing business in Europe and North America. The job assignment was to develop the company into a truly global organization with direction of expansion mainly to Asia and South America. Five years later the company commanded a global network with 5 new affiliates in Asia: Japan, China, Singapore, Malaysia, Vietnam with further activities in India, Thailand and Taiwan and 2 new affiliates in South America, Brazil and Chile. The insights, experiences and conclusions gathered along this path of seeding and growing these young companies established the basic concept to this book.

Credit goes to Professor Reinhard Haberfellner for scientific and practical guidance throughout the entire process, to Professor Ursula Schneider for second expert witness, Bernhard Cociancig for constructive advice and helpful proofreading and Gerald Hemedinger for his mentoring support and cooperation throughout the years while building & shaping TIGER'S future together.

1.2 The 4 core scientific questions

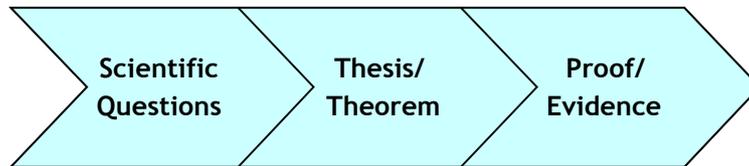
- 1. Why is the number of SMEs with foreign activities so small and what are the reasons that keep them confined to their domestic markets?**
- 2. Have the changes in business environment eliminated barriers that up to now excluded SMEs from global expansion and made it an exclusive right of larger corporations? As a consequence thereof, are SMEs now in a position to globalize equally successful?**
- 3. Can globalization / regional expansion rise beyond the level of opportunity and reach a dimension of strategic necessity for an SME?**
- 4. What are the key factors for successful SME globalization?**

1.3 Research method

The concepts and conclusions presented in this book represent the culmination of lines of inquiry.

- Defining the problem and the scientific questions
- Development of propositions on successful globalization of SMEs
- Researching existing literature
- Refinement of propositions
- Field research based on case studies in successfully globalized and non-globalized SMEs.
- Test of hypotheses, comparison of results across methodologies
- Generalization and conclusions

The scientific approach for the thesis was designed as question - thesis / theorem - example / evidence process.



All statements and theorems which are not marked and cross referenced to existing literature reference represent own generic thoughts, ideas and concepts and are formatted in bold letters.

Example and evidence to theorems is provided through

1. **Field research**, in which SME's globalization behavior has been investigated. In that context, SMEs which have globalized successfully as well as those which have failed to do so were used as samples for this thesis, regardless of their heritage.
 2. **Existing literature** researched in libraries and on the Internet and referred to whenever applicable.
- **Success factors for internationalization** have been derived from globalized SME samples that have progressed along the path of internationalization successfully.
 - **Samples that so far have not internationalized or have had less success in doing so** were cited in relevant chapters to serve as examples for theorems.

Success has been defined by means of

- age of SME,
- sustainability of development,
- leadership position (at least in the actively served markets, mostly worldwide),
- healthy profitability,
- sound debt/equity ratio (wherever accessible)

Out of the successful SMEs, the majority is in a position to look back on a historic development over 2 or more generations: clear evidence of sustainable management. This group is holding leadership position in niche markets and has its origin in markets with serious constraints in terms of size of its domestic home market. Their success can be expressed by market share ratios on the one hand proving their dominance, as well as by market consolidations starting to take place where samples selected remain as survivors.

The **total number of samples** used for this field research is smaller than that of other field research projects as found during literature research, which were carried out through standardized questionnaires, where companies had to respond to particular questions. These data have then been statistically processed to conclude on certain behaviors.

In this thesis the quantitative deficiency has been compensated through a higher degree of quality in the field research process, as **all samples have been interviewed personally, in several cases more than one time.**

All **interviews** were carried out from 1997 to 2001 and structured by means of the thesis-fit-matrix² serving as questionnaire. Documentation was done by means of written notes; none of the interviews was taped. On the average an interview lasted for about an hour and a half.

² See page 200, Graph 29.

1.4 Executive Summary - Synopsis of core thesis / theorems

QUESTION 1 - *Why is the number of SMEs with foreign activities so small and what are the reasons that keep them stuck in their domestic markets?*

- **SMEs traditionally lack sufficient strategic management.** Basic tools like a SWOT³ analysis as well as the conclusions and results thereof are missing in the majority of cases. Hence there is neither awareness of their position in terms of strengths and weaknesses, nor of the opportunities and threats that are rising with globalization. - This unawareness of their concern to globalization is to be seen as the main factor.
- **Language barriers** represent a second, sometimes-insurmountable barrier for many owners and senior management people.
- The fact that many SMEs are looking back at an above average lifespan of their companies, often transferred over more than 2 or 3 generations, lulls them into a **false sense of security** believing that their business is stable and growing as long as they keep on doing what their ancestors did. They do not realize that the **protection of their businesses was strongly ensured by legal frameworks of import limitations etc.** - trade barriers that mitigated in a very short period of time.
- This deficiency includes the **lack of market intelligence and early warning systems.** The rise in the concern to globalization for the majority of SMEs with passive-external reactive behavior is perceived too late to increase the intensity of competitive strategies.
- **Insufficiencies in strategic management and unawareness of changes in their company's business environment** which lead to an **increasing concern to globalization** are the key factors responsible for the underdevelopment of SMEs foreign activities.
- Confronting owners and senior management of leading SMEs, mainly in the highly competitive markets of Austria and Germany, with the question about **the reason why they weren't equally successful in foreign markets as they are in their domestic markets**, they were

³ SWOT ... Strength and Weaknesses, Opportunities and Threats

stunned. **SME managers** admitted that they had simply been **constrained by their mental boundaries**. Obviously they have **sacrificed huge opportunities in the past due to their regional limitations**

Field research showed, that

1. The **majority of SMEs shows external reactive behavior**, operates in **more or less protected markets** and is handed over from generation to generation.

Aside this first group of SMEs, that has enjoyed a protective environment for a long time which is diminishing now, there is a second:

2. The **minority group of SMEs** show an **internal proactive behavior** and are **highly profitable** through their position as **niche manufacturers, high-tech specialists or flexible service companies** : it is exactly this group that is bearing such a **high success potential for extending their markets on a more global basis**.

QUESTION 2 - Have the changes in business environment eliminated barriers that up to now excluded SMEs from global expansion and made it an exclusive right of larger corporations? As a consequence thereof, are SMEs now in a position to globalize equally successful?

Conclusion on research shows that:

- **Environmental changes have led to the result that SMEs can globalize successfully**. The most successful SME's today in terms of market share held, profitability and growth are the ones, which contend - *"our market is the world"*.
- **A perceived growth of the concern to globalization results in a higher intensity of SME's competitive strategies**.

The thesis provides scientific prove and evidence that **SMEs, even as a small or medium sized company, are prone to globalize successfully if they comply to a scheme of mandatory prerequisites** which have been identified as **key success factors**:

1. A specific degree of uniqueness in the market
2. Niche position and mikromarketing skills
3. Mastering the virtues of smallness
4. Modern organizational background that commands today's Information Technology Systems in a sufficient manner as well as a systematic approach backed up by theoretical preparational research.
5. The transportability of goods and services
6. Reaching critical market share and market leadership
7. Available human resources for an internationalization project

Due to the dramatic changes in business environment during the last two decades, becoming a global player is no longer an exclusive right of large companies or state owned conglomerates with powerful political connections.

Hermann Simon concludes in his bestseller "Hidden champions", that these hidden champions prove that small companies can surmount barriers, which are mainly mental, to become global competitors. The world, having shrunk in size, is accessible. For many companies, ignorance of their opportunities is their only boundary. The hidden champions have overcome these mental barriers and successfully negotiated the difficult road to globalization. They can serve as role models for the many firms about to sail the same course.⁴

SMEs which have not seriously looked into the question of geographical expansion will have to learn quickly, whether they should set their sails to the sun seeking the opportunities of a global market or better set focus on other strategic goals and/or alliances. In any way, the mere fact of knowing and understanding better their concern to globalization, who and what they are and which strategy is the most suitable one for them will put them in a more advanced position.

QUESTION 3 - Can globalization / regional expansion rise beyond the level of opportunity and reach a dimension of strategic necessity for an SME?

⁴ Simon, Hermann, Hidden Champions, page 97

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- Studies⁵ proof that the concern to globalization is in the same way affecting SMEs as large corporations. The trend as such is increasing strongly.
- Consequently SMEs are suffering from harsher competition more and more each year, that in combination with lack of competitive advantage thus strategic differentiation.
- SMEs that comply to specific criteria e.g. transportability of goods and services, sufficient USP potential, niche marketing, etc. without suffering from the impacts of globalization to their own businesses, geographical expansion does represent a strategic opportunity.

Under specific circumstances the opportunity to expand regionally / globally can reach a dimension of strategic necessity forcing the SME to go that direction or loose its independence on the medium or long run:

- For SMEs with a high concern to globalization the opportunity of internationalization turns into a true strategic necessity. A high concern to globalization stands as synonym for a very high impact of globalization with explicit environmental characteristics exposing them to increasing threats from outside, mainly larger foreign competitors penetrating into their protected home markets, the opportunity expands and develops to a level of strategic necessity.
- More SMEs need to develop into „Hidden Champions“ evolving as Hermann Simon defines them: *„Their presence in target markets throughout the world is all encompassing and highly impressive. Most are true global competitors. Predominantly they establish direct contacts with customers through their own subsidiaries in the target market countries. They don't like to delegate customer relations to middlemen, importers or distributors. They are close to their customers when it comes to languages. Their knowledge of foreign languages and their internationalization are necessary prerequisites of their business success.“*⁶

⁵ Bamberger, Ingolf, Anpassungsstrategien von KMUs and die Globalisierung der Märkte, Universität Essen, 1995

Abels, Hermann / Studer, Hans-Peter, Internationalisierung von KMUs, St. Gallen
Schmitt, Eckart, Strategien mittelständischer Welt- und Europamarktführer, Gabler Verlag, 1997

⁶ Simon, Hermann, Hidden Champions, page 3

For owners and senior management of small and medium sized enterprises it is about time to **evaluate “their” concern to globalization**. It is necessary to realize the urgency of threats from outside and the huge rewards waiting for those who take action to go global and **maintain their company’s independence**.

QUESTION 4 - How to plan and carry out a successful SME globalization project?

In chapter 8 Suggestion for SME globalization / internationalization, the thesis identifies and elaborates on the right process to go global, which steps to take in which logical order, which considerations to take, which methods to apply and which barriers and stumbling blocks to overcome.

- Step 1 starts with a **systems-check to evaluate the suitability of the current SME’s position for globalization**.
- Step 2 requires conducting **market screening on a truly worldwide basis** as contrast to traditional regional perspectives.
- Step 3 introduces a **new ranking concept of market evaluation criteria to select markets**. The priority is set on the attractiveness of a market. **Geographical distance is reduced to a factor with decreasing importance**.
- Step 4 describes a new mode of **geographical expansion that is to be seen as a mix of parallelism and sequence**. The approach is called **“concentrated speed seeding”** and represents a **taylorized approach for SMEs** targeting for a maximum of market entries in the shortest period of time.
- Step 5 outlines the **various ways to pursue in terms of organizational entity set up**, challenging the **ideal mix between centralized & decentralized organizational set ups**.
It advises to undertake mandatory legal steps such as **trademark protection** at a very early stage of expansion as one of the first activities after a market has been selected.
It refers to the **importance of human resource** as this has been identified as the most common failure of foreign investments according to statistics.
It illuminates the importance of a **sound IT basis** to leverage on the benefits the Internet is offering.

It explains the **legal entity set up** and provides an outlook how to develop a global organization in a sound balance between centralization and federalism.

- **A minimum of theoretical “hard slog” is deemed mandatory in a globalization project:** own experiences as management consultant as well as expertise exchanged with alumni from university led to the conclusion that in the practical business life there was a serious lack of even a minimum amount of theoretical approach in SME’s business activities. Any kind of problem is approached via the trial and error concept in a very “hands on approach”, which is completely opposite of what students are trained to do at University or High school. Together with former colleagues it was concluded that this is sufficient in many or even the majority of cases, but insufficient and wrong if applied on all cases. Consequently, one further claim of this thesis is to apply a minimum of theoretical homework in terms of market research, SWOT-Analysis⁷ and strategic planning, thus leverage the quality of decision and truly get into a level of strategic management rather than operating on an opportunistic short term behavior.

The fact that SMEs have a strong preference for practical approaches helps to contribute to the flexibility and responsiveness advantage over larger corporations. The same holds responsible for the reason that SMEs are falling behind dramatically in some critical disciplines such as strategic planning, marketing and human resources management.

The approach of a globalization project has to include this reasonable amount of theoretical work necessary to backup the strategic planning considerations. Managers and entrepreneurs find this clearly above their usual extent but finally recognize its usefulness. On the one hand it provides basic macroeconomic data mandatory for a full understanding along with some other factors to be considered such as politics, religion, migration, etc. followed by a guideline concept that leads them through the project and at each single phase tries to outline the various possibilities how to approach situations along the way.

⁷ SWOT ... Strength and Weaknesses, Opportunities and Threats

Speed in many facets such as decision-making, information channeling and dissemination, etc. had been identified as a **key factor for success**. Speed represents a classical strength of SMEs. To put it in a nutshell, it is that **today the fast mover beats the slow mover. It is not any longer as it used to be, that the large guy beats the small fellow.**

- **The most specific recommendation is to remain narrowly focused and to grow through regional expansion.** By means of illustration, instead of diversifying from supermarket business to hotel industry in the same town, it is preferable to stick to supermarkets and expand into a neighboring town. Excelling in supermarkets (apples) however, does not necessarily carry over to excelling in hotel management (oranges), because one has to deal with a totally different clientele. **The instruction for a regional company is that no matter how small a market, it has to have a leader, the position for which an entrepreneur should aim.** Hidden championship does not depend on the size of a market.

Simon refers to a case of a high-tech supplier to the banking industry illustrates the relevance of internationalization. This U\$ 100 million company holds 80 % of the very demanding German market but so far has refrained from going international. It took some time to convince the management that if they are able to get 80 % of a market as difficult as Germany, then they should be able to conquer their share in other countries. Each small company that is excellent in one regional market should seriously consider going international.⁸

⁸ Simon, Hermann, Hidden Champions, page 258