

## **Small and medium sized enterprises (SMEs) – winners of globalization?**

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### **Introduction**

The globalisation of markets is not only a challenge for large enterprises but also concerns more and more medium sized companies. Small and medium sized companies (SMEs) are more engaged today in the course of new technological developments, new markets and especially services than often assumed and recorded in statistics (Feldmeier, 2006). Especially because of their innovative drive SMEs are becoming an increasingly important factor in the competitiveness of national and regional economies. To overcome the limitations of regional markets, specialized SMEs are increasingly trying to position themselves on the world market.

### **Successful internationalization of SMEs – assessment of existing theories**

From a microeconomic as well as from a macroeconomic perspective it is important to investigate the question of the concrete orientation of the internationalization of SMEs. A basic problem in this matter is that neither a comprehensive theory of internationalization of SMEs exists (Krämer, 2003), nor is there sufficient empirical evidence to justify the assumption that experience from large-scale enterprises can also explain the internationalization of SMEs. Attempts to explain internationalization refer to current theories, which are based on the internationalization of large and/or multinational companies which increasingly evade their national economies through their strategic location policy (internationalization).

According to this SMEs act in their processes and strategies of internationalization parallel to large scale enterprises and are in a complementary relationship with them in their foreign business. For example it is implied (in examining individual cases of internationalization)<sup>1</sup> that there is a significant correlation between the size of SMEs and the proportion of their exports (Krämer 2003). According to current theory, the forms of internationalization differ between large scale enterprises and SMEs and it is assumed that the former tend to direct investments, whereas SMEs, due to their low financial power, prefer (indirect) imports (N.N., 2005). In addition, it is often stated that SMEs mainly follow in the footsteps of great pioneers in their cultivation of foreign markets in order to earn “follower advantages” as their entourage.

Yet, numerous studies of individual cases concerning the behavior of internationalization of SMEs prove that SMEs not only differ fundamentally from large scale enterprises but also consciously seek alternative ways in the development and adaptation of foreign markets and the selected steps of internationalization respectively. Thus, conventional assumptions about the fundamental aptitude of SMEs for internationalization are apparently incorrect (EU Commission, 2003; Feldmeier, 2003). The traditional hypothesis: “The smaller an enterprise, the less its tendency to internationalization” is thus – as will be shown in detail – not tenable. It assumes that internationalization can only be successful with certain entrepreneurial resources and forms of internationalization, which imply a higher degree of resources bound abroad, entrepreneurial financing and management capacities, which are not available in most SMEs.

The size of enterprise is not the main factor which limits the competitiveness of SMEs but rather the restrictions related to it, such as e.g. a relatively high degree of specialization of the product range, a high degree of fixed cost charges and/or little (cost-critical) production quantities due to closely limited domestic markets, because SMEs mainly operate in tightly defined market niches. The size of the

<sup>1</sup> Forms of internationalization are especially indirect export, direct export, sales subsidiaries, licensing, joint ventures, production abroad and subsidiaries abroad.

enterprise is only of importance for the internationalization of SMEs as far as a minimum size represents a necessary prerequisite for the use of a competitive advantage. This is only achievable through a directed internationalization which reverses the causal relationship assumed to date. Not the already existing advantages of scale, but their development are essential for internationalization of many SMEs.

Most researchers so far take no account of qualitative factors of definition and success of SMEs independent of the size of enterprises, nor do they recognize the fact that SMEs are not categorically losers of globalization but establish their business on the strength of world market leadership (“hidden champions” through “first mover advantages”). SMEs differ from large scale enterprises inasmuch as they consciously choose alternative ways in the adaptation and development of foreign markets and the chosen steps of internationalization (Feldmeier, 2007).

### **Strategies for successful internationalization of SMEs**

In this paper we will deduce strategic factors of success for the internationalization of SMEs based on case studies of a network research project<sup>2</sup>.

The intention of this empirical investigation was to compile information on the internationalization of mid-sized enterprises and relevant factors contributing to their success. In particular, their competitive strategies and advantages, processes of development of foreign markets, international supply and distribution channels, production design as well as cooperation established with foreign partners were analyzed. As criteria for the measurement of international establishment of the selected enterprises the following indicators were chosen: international market leadership in specific fields of business activity, distinctive and widely spread export and import activities and/or larger direct investments in the form of branches abroad and foreign subsidiaries.

Keeping in mind that concepts of success can not be directly copied from another enterprise, we intend to provide a framework of orientation for those enterprises that wish to expand their business in the international market. Each enterprise is characterized by a unique history, which is reflected in their corporate culture and staff selection and has to be taken into consideration when entering foreign markets. Each enterprise is determined through certain temporal paths (Schreyögg et al., 2003), which has to be ascertained when examining certain branches as well as the target countries. This makes it even more difficult to identify success factors which are relevant across countries and different industries. Nevertheless, the following results based on “best practice” cases may offer useful orientation for corporate-, industry- and country-specific internationalization of SMEs.

### **Quality leadership in narrow market niches**

The competitive positioning of the mid-sized enterprises analyzed is characterized by specialization in clearly defined market segments, i.e. niches of the total market. In those niches they focus their business activities on specific (core) competences and market their service in Europe – and in some cases – globally. In their segment they focus on a wide range high quality service portfolio with special problem solutions primarily for narrow target groups. A transnational reputation for outstanding quality in a special area of expertise, developed over decades, is a fundamental competitive advantage in this context. The references are based on a high degree of customer satisfaction.

The positioning in narrow market niches generally takes place through services which are qualitative, functional, design-related, technological and/or high value service and top ranking. Apart from the quality of products, especially product associated services serve to distinguish them from competitors. In order to maintain the existing service advantages, the products and manufacturing processes are continuously refined.

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<sup>2</sup> In cooperation with eight Chambers of Commerce in Northern Germany, the proceedings of 65 internationally successful mid-size companies were examined. The research was conducted through interviews in internationally active companies identified as SMEs, organizationally and legally independent from multi-corporate enterprises and conducting their own business. As a rule, these were companies managed by their proprietor and/or family owned. The results of this study were first published by Dieckmann (2007).

For the preservation of this continuous innovative dynamic and pioneer role in their particular market segment, especially a high degree of customer proximity, creativity and flexibility are decisive. Sometimes they achieve an exceptional position, which is difficult to imitate, so that only few competitors with comparable profile of competence exist in market. Advantages in quality and image support customer loyalty and are effective in reducing the competition with imitators on the basis of price.

### **Specific know-how clusters**

High market specialization requires the creation and the management of specific knowledge. The establishment of distinctive customer, market and expert knowledge is essential to remain competitive. This know-how is based on experience and thrives on a monitoring system for customer problems combined with state of the art knowhow in the special field. With distinct customer orientation potential problems are analyzed and corrected as soon as possible. Typical approaches are individual analysis of requirements, intensive communication with customers, mutual exchange of ideas, customer participation at an early stage of the solution finding process and in-house problem simulations. Process innovations and new demands often originate from the exchange of information between customer and supplier and are a driving force for innovations and new standards on the world market. Communication and close cooperation with specialists at universities and research institutions is essential to keep up with international developments and to identify problems which warrant new basic research.

### **Qualified personnel**

The employment of qualified and experienced specialists represents a necessary prerequisite for mid-sized enterprises to be successful in the international market. The staff is emphasized as the most decisive pillar of professional competence and knowledge, their continuous education and training is rated as being of primary importance. In all sectors of the industry the shortage of qualified specialists is seen as a major factor limiting the international competitiveness.

Especially for employees directly involved in business abroad, adequate knowledge of foreign languages in addition to the subject specific qualifications is considered as a critical success factor, since a personal basis of communication and trust in foreign business partners can only develop through them. Apart from the knowledge of languages, especially passion for travel, flexibility, open-mindedness and a high degree of understanding of other cultures are seen as prerequisites for successful international business. The required intercultural competences are usually acquired through international experience by the employees concerned. Often the companies have recourse to immigrants from the respective target countries, which are acquainted with the cultures of the home as well as the host country.

### **Direct cultivation of foreign markets**

The potential of foreign markets is sounded out primarily through an attentive media analysis, thorough research in professional magazines, the visit to trade fairs and/or personal on-site investigation. International and national trade fairs are the most prominent platform to establish contacts with potential foreign business partners and customers. Contacts in the form of personal visits in the target country foster the development of business transactions. Existing contacts prove to be the best multipliers to attract new customers or distribution partners. In this context, people who are acquainted with culture and language serve as valuable communicators.

The distribution of products and services of the SMEs abroad mainly takes place through their own representative offices or locally established on site sales staff. Yet, direct selling from the home location is generally preferred for services which tend to be of low frequency, such as e.g. special facilities. Representative offices abroad are either opened by themselves or are managed in cooperation with existing partners on site. Contractual partnerships with locally established sales people (such as e.g. specialized wholesale merchants, contractual sellers or agencies), who serve as sales, distribution

and service centers for the respective market are typical forms of cooperation. These partners may also serve as market observers and establish first contacts to potential customers. The establishment of direct personal contacts with potential distribution partners is often realized at trade fairs or direct addressing on the basis of branch information. The decisions in favor of selected distribution ways are often made in a situation-related context.

Often sales partners are selected by chance, depending on which contacts emerged at trade fairs, through already existing business relationships or on personal trips. The most important criteria for the selection of potential sales partners are their expertise as well as already existing contacts in the branch, existing knowledge of the language and mentality, an existing customer base and their reputation and credit rating. A personal basis of trust and the motivation of the potential partner to promote the business for mutual benefit are of essential importance.

The cooperation often consists of exclusive sales with exclusive distribution character so that the partners are not allowed to offer competitive products. The enforcement of exclusive contracts depends on the market power of the partners involved. The offered services are either performed by the local partner on their own account or on external account based on commission payment.

Apart from the cooperation with the foreign partners, proprietary branch offices or the foundation of subsidiaries with sales and service function are the most important forms of presence in the target market. Variants exist in strategically important markets or markets with a high turnover or countries with restrictive legal frameworks or local peculiarities, which do not permit any alternative form of market cultivation.

Evidently the approaches described in the literature to date, i.e. the sequential development of foreign markets, starting with export passing on to cooperation and further to the foundation of subsidiaries, do not appear to be typical for SMEs. Rather the conditions found in the target country influence which form of internationalization is regarded as appropriate, which has led SMEs to “leapfrog” i.e. to skip some forms of internationalization and enter more resource intensive forms such as joint venture and subsidiary companies (Enßlinger, 2003).

### **Favorable international conditions of supply and production**

Simple parts, which can be standardized, are needed in large quantities and/or can be kept in stock, may be imported to benefit from low-priced components. The imported primary products are then integrated into the end product to improve margins and to remain competitive in terms of price.

The supply of imported primary products is usually organized in the form of contracts with independent suppliers or partner enterprises, which are bound by contract. As a rule, the production of finished parts, components or modules which are outsourced abroad, takes place with production standards specified by the importing SME and often includes supporting technical service.

In some cases proprietary investments abroad are preferred to transfer sensitive and labor-intensive production steps to subsidiaries abroad, in which case used machines and facilities from domestic production plants may be transferred to the production facilities abroad. Proprietary production capacities for market development may be needed in countries with specific limitations, e.g. in countries with high import barriers or to minimize transport cost to remote markets.

The purchase of external and internal primary services from abroad and outsourcing of production steps abroad are limited for specific primary products, which:

- are required in small quantities, i.e. the purchase from abroad does not offer significant savings,
- are required in different versions, depending on specifications of individual orders requiring immediate in-house reaction to ensure fast delivery,
- require a very high degree of know-how to assure the quality needed and/or
- are prone to imitation if sensitive technology has to be transferred.

This kind of primary product is either produced at the home base or purchased from specialized suppliers located close to the home base. This enables a more flexible reaction to fluctuating order inflow. In-house production is preferred to ensure special quality requirements, which leads to a higher vertical range of manufacture.

### **Functioning co-operations**

Technology intensive SMEs are especially aware of the fact that international co-operations can increase their competitiveness and are often the key success factor. A significant transfer of know-how is taking place in this area (Gerum, 1999).

The co-operation of internationally operating SMEs with partners abroad is generally set up for a long term and is understood as a strategic partnership. To ensure quality and safety standards the partners are supported with training and extensive technical support. Mutual trust and common interests are the basis for the establishment and long term maintenance of business co-operations and essential for success. To assure smooth business, problems must be openly discussed with due respect for each other's position, and enough time must be allowed for extensive consultations. Concerted visits to or presentations at trade fairs are the preferred forum for this.

### **Success as cluster of existing potential for internationalization**

The case-specific examples analyzed indicate that successful internationalization is not so much based on individual factors, which have previously been treated in an isolated way in the literature, but are generally based on a sensible combination of success components, as listed above.

Especially the clusters of a tight market niche positioning, specific know-how, a network of long term business relations, advantages in market experience, individual and unique product/service combinations, a high degree of customer orientation, an intelligent design of transnational activities to generate added value, efficient organizational and decision-making structures, and, last but not least, highly qualified personnel enable the medium sized enterprises to generate continuous innovations, to expand market penetration, to seize new market opportunities and not only to hold their ground in a competitive world market.

The characteristics of successful SMEs outlined have revealed that they deploy integrated forms of internationalization and opt for a calculated mix of alternatives instead of following isolated motives of sales and economization. Especially the wide range of simultaneous exports, imports, formal and informal co-operations, as well as direct investments enables them to benefit from network synergy, which could not be offered by individual forms of internationalization (DIHK 2005).

The internationalization of SMEs frequently consists of a bundle of activities which complement each other rather than being built up sequentially. Instead of "either-or" and "first-then" decisions, "as-well-as" approaches are typical in successful SMEs. A well balanced mix of different forms of internationalization enhances the probability that transnational activities of SMEs are successful.

### **Conclusion**

The identified success factors of internationally active SMEs indicate that they are not threatened by the ongoing globalization. Instead, through internationalization they achieve increased sales and lower cost, which enables them to compensate existing disadvantages due to their company size. Successful internationalization results from competitive advantages which are independent of size, such as specific know-how, experience from their domestic market, a high degree of specialization, individual product/service combinations and close customer relationships. Based on these factors they can establish themselves successfully against large scale enterprises and even achieve global market leadership with their niche products and corresponding service.

## Zusammenfassung

### **Kleine und mittelständische Unternehmen (KMU) – Gewinner der Globalisierung?**

Die Globalisierung von Märkten stellt nicht nur eine Herausforderung für Großunternehmen dar, sondern betrifft in zunehmendem Maße auch mittelständische Firmen. Vor allem aufgrund ihrer Innovationsdynamik werden KMU heute zu einem immer größer werdenden Bestimmungsfaktor der internationalen Wettbewerbsfähigkeit der nationalen Volkswirtschaft.

Von grundlegender wissenschaftlicher Bedeutung ist in diesem Zusammenhang die Frage nach der konkreten Ausrichtung der Internationalisierung von KMU. Ein Grundproblem hierbei besteht darin, dass es weder eine umfassende Internationalisierungstheorie von KMU gibt noch hinreichende empirische Untersuchungen über dieses Themengebiet existieren und man sich bei der wissenschaftlichen Erklärung der Internationalisierung von KMU vorliegender Erkenntnisse und Erfahrungen von Großunternehmen bedient und diese auch für KMU als allgemeingültig hingestellt werden.

Ziel dieses Beitrags soll es sein, auf Basis vorhandener Einzelfallstudien sowie einer eigens im Rahmen eines Verbundforschungsvorhabens durchgeführten Studie strategische Erfolgsfaktoren für die Internationalisierung von KMU abzuleiten und somit einen Beitrag für die Entwicklung einer KMU-spezifischen Internationalisierungstheorie zu leisten.

Die herausgestellten Erfolgskonzepte von international erfolgreichen KMU zeigen, dass KMU nicht zwingend von der Globalisierung benachteiligt sind. Vielmehr ermöglicht ihnen die Internationalisierung, entgegen gängiger Lehrbuchmeinungen, mit der Erreichung erfolgskritischer Absatz- und Kostengrößen erst vorhandene Unternehmensgrößennachteile auszugleichen. Ihre Internationalisierungserfolge resultieren nämlich meist aus größenunabhängigen Wettbewerbsvorteilen, wie spezifischem Know-how, heimatmarktbezogenen Erfahrungsvorsprüngen, hohem Spezialisierungsgrad, individueller Produkt-/Servicekoppelungen sowie engen Kundenbeziehungen.

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