Burakovs′kyj, Ihor; Voloshyn, Andrii

Article

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THEORETICAL APPROACHES OF SME INTERNATIONALIZATION

Igor Burakovsky, Professor
Andrii Voloshyn, PhD student
Department of Economic Theory
National University "Kyiv - Mohyla Academy", Ukraine

Abstract

Globalization is one of the key features of today. Most economies are open and therefore economic agents are exposed to external influences, which can be manifested through exports, imports and competition. The main issue of the paper is how an enterprise in the SME sector should carry out the process of internationalization based on available resources and the economic system of the country in which it operates. The main theoretical models of internationalization are considered in the paper and their comparison with the possibility of application in the Ukrainian realities is made.

Keywords: SMEs, internationalization, enterprise, Melitz model, Uppsala model

JEL Codes: F13, F50, F60

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Introduction

Globalization is one of the key characteristics of the world economic system at the present stage of development – almost all economies are open.

Today, there is a situation that almost all economic agents are exposed to external influences in one way or another: they carry out export / import activities, compete with foreign agents – so the issue of internationalization strategies at the national and micro levels is becoming increasingly important. Also, due to increased competition in the world market, it is important to comprehensively study all kinds of benefits that can be achieved by the company through internationalization.

The internationalization of enterprises and the integration of national economies into the global economic system give impetus to the economic growth of countries with economies in transition. Therefore, under the current conditions of SMEs (openness, interdependence), the policy to support this type of enterprise is objectively changing (Vargas-Hernández and Martinez, 2017; Horobets, 2019; Horobets, 2020).

The main task of building internationalization strategies is to maximize benefits while minimizing possible risks. Thus, the process of internationalization of SMEs in the EU and the corresponding benefits from international activities can be seen in the Figure 1 – just over 55% of all SMEs are active in sectors where export activities bring less than 5% of total corporate profits (1 column). In sectors where 5 to 10% are generated from exports, about 39% of SMEs work (3 column SMEs). In a sector with very high export activity (column 5), the share of SMEs is about 35%, which is the relatively lowest figure for this type of enterprise in all sectors.

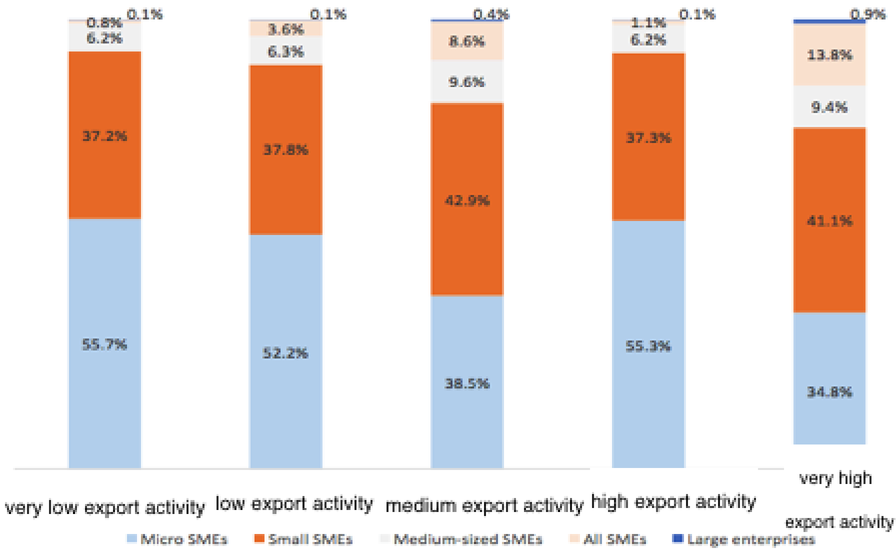

Figure 1. Distribution of SMEs and Large Enterprises depending on Export Activity by Sector in 2017 in the EU-28 in the Non-financial Sector

Sources: calculated by the authors based on Eurostat data

In general, it should be added that the export activity of SMEs is a key indicator of measurement, as exports reflect the international competitiveness of products / enterprises in foreign markets.

First of all, it is important to consider the essence of the process of internationalization at the level of the enterprise (Figure 2).

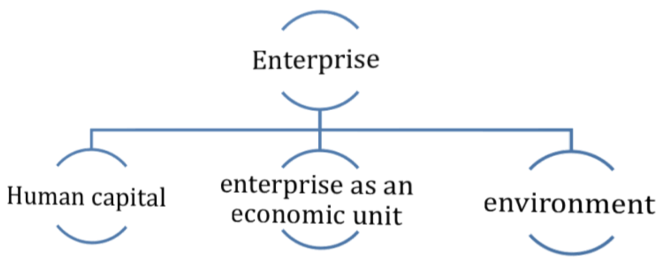

Figure 2. Theoretical Components of the Analysis of Internationalization of the Enterprise

1. Human capital – in the process of SME internationalization, the entrepreneur (entrepreneurial team) acts as a person who decides on the company's readiness to enter the international market based on the available stock of knowledge and skills about the process, methods / options for entering the market and its further analysis. Decision-making implies the presence of a full range of personnel in the enterprise who have the knowledge and skills to implement this decision. It is necessary to understand the "dualistic" essence of internationalization - the company can carry out both export and import activities, which in both cases are an international activity

(Agndal and Chetty, 2007).

2. Enterprise as an economic unit – the presence of production, financial and technological prerequisites at the enterprise for the production of quality (competitive) products / services that will be in demand in the international market (Barney, 1991).

3. Environment – external externalities that affect the process of internationalization of the enterprise – competitors, features of individual markets, regulations in the international market, customs tariffs. Given the high rate of development of information and communication systems, digitalization of the global economy and reducing the asymmetry of information - in this context, internationalization (export / import activities) is a "must have" scenario of enterprise development.

Internationalization raises the following questions for the company:

- which market to choose – it is about establishing criteria for market attractiveness for the firm, finding a balance between benefits, costs and risk;
- depending on the time of entry into the international market - companies can be divided into "pioneers" and "followers". In fact, these two scenarios for any business are a process of "learning by doing" – some entities are more likely to acquire knowledge about the process of internationalization, its stages and possible risks - others need more time. The first are those firms that enter the international market before any of the representatives of this type / industry enters the foreign market. Secondary are those firms that begin international activities after other firms. Both options for the development of internationalization have advantages and disadvantages. The former may be pioneers in the market, but at the same time they may incur large costs. With this in mind, small businesses can simply copy the first participants, avoiding the risks they have already taken on and have less financial loss. At the same time, top firms will have more competence in the chosen market (Johanson and Wiedersheim-Paul, 1975).
- the level of internationalization – this indicator depends on the volume of goods / services that the company can provide to the international market based on its production capacity. Large-scale internationalization involves the rapid entry and mobilization of significant resources. Small scale allows the company to learn in the market, gain new knowledge, with less risk.

There are the following approaches to the internationalization of SMEs: the step-by-step approach, the network approach and the international approach.

The main factor that explains the classification by type of stage (the stage approach) is the knowledge gained by the company by studying the experience in foreign markets. This makes it possible to reduce the "psychological distance" from foreign markets and, thus, to expand its activities in them.

The economic / international approach (the international approach) focuses on organizational resources (financial, production, technological) to explain the internationalization of firms. According to this approach, these benefits are seen as tangible resources controlled by the firm (Barney, 1991).

Social relations are a dominant factor in explaining internationalization within the network approach. The availability of highly specialized and transferable resources in SMEs (thus not very strategic) is important for networking. However, these resources can only be fully utilized if SMEs have great potential for "networking".

SMEs that do not have this capacity will begin the process of internationalization gradually. In terms of resources and competencies, the relationships established in networks can be seen as intangible resources (Etemad, 2005).

There are three main stages in the process of internationalization of SMEs:

1) pre-engagement: firms operate only in the national market; firms that are seriously planning to export; firms that have already exported but no longer do so;

2) initiation phase – the firm partially exports its products / services;

3) extended / deepened phase – the company regularly exports and has experience abroad.

Resources and competencies can be used to maintain the benefits of ownership (experience, formation, attitude), the benefits of location (provision of production resources, information) (Johanson and Vahlne, 1977).

These developments show that all these theoretical approaches, which explain the dynamic process of internationalization of small and medium-sized businesses, are based, implicitly or explicitly, on the concept of resources and competencies. The process of internationalization is the result of a combination of different resources and competencies controlled by SMEs.

Melitz Model

One of the conceptual principles of the model is that the firm should consider whether the amount of variable trade costs associated with exports is greater than the fixed costs of acquiring or establishing a foreign sales office. (Brainard, 1997; Yeaple, 2003; Helpman, 2011).

In economic science, there is the question of why only some firms in one industry can export goods to foreign countries, while most firms operate only in the domestic market.

Internationalization imposes additional costs on the enterprise. First of all, exporters should be able to cover additional fixed costs for servicing a foreign market, such as setting up and servicing a foreign sales network.

Second, exporters face additional variable transaction costs, which can be cumulatively formed from insurance fees, freight costs or trade barriers. As a result, only the most productive firms can become exporters, as only these firms can make a profit by participating in international trade (Aspelund et al., 2007).

According to this model, causation depends on productivity and export activity, meaning that this exogenous level of productivity determines export activity, not the other way around.

While Melitz focuses on exports, Helpman offers a broader model that includes foreign direct investment (FDI). In his model, Helman views horizontal FDI as a foreign entity engaged in the same activities as the parent firm. Horizontal FDI can reduce variable trade costs: transport and coordination costs, changes in tariffs (Agndal and Chetty, 2007).

Another variant of the export activity scenario is “OLI Model Ownership, Location, Internalization” – a model of ownership, location and internationalization.

This model analyzes the main motives that force companies to enter the international market by creating subsidiaries or FDI (Helpman, 2011).

The OLI model distinguishes the following types of "motives – advantages" from the implementation of export activities:

• having certain specific competitive advantages, the firm (SME) can export them to subsidiaries through FDI;

• there are specific competitive advantages related to the location of the enterprise - the decision to establish a subsidiary in another market or the beginning of international activities may be due to excess production factors in a new market, cheap labor, highly developed infrastructure (Aspelund et al., 2007).

Based on the theoretical data of the model – competitive advantages can be applied in the direction of both export and import activities of the enterprise.

Uppsala Model

One of the most well-known dynamic theories of internationalization is the Uppsala model.

This model was developed by Swedish economists Johansson, Videlsheim-Paul and Vahlne (1975, 1977). The two main theoretical concepts of the model were the learning process and psychological distance. The training process meant the experience of the enterprise in the market (a set of business strategies, the scheme of business process settings), which was used to start activities in the international market (Forsgren and Hagström, 2006).

"Psychological distance" – linguistic / cultural aspect, political system operating in the foreign market. This concept was used by the authors to explain that the smaller the psychological distance between the company and the new foreign market, the greater the activity of the firm in it. In contrast to the “motives - advantages” of the OLI model, the Uppsala model assumes that any enterprise goes through 4 main stages of internationalization in line with export activities:

1) lack of regular export activities;
2) export through independent intermediaries;
3) creation of trade representations or creation of production units abroad.
4) creation of production units abroad

In 1990, Johansson and Vahlne defined internationalization as the interaction between the consistent development of knowledge about foreign markets and the gradual mobilization of resources for international markets.

According to this model, there are two aspects of the process of internationalization, static and dynamic. Dynamic aspect - the resources available to the company affect the decision-making process over time and the type of economic measures (export / import) that it will carry out.

Under the static aspect, the authors understood that the distribution of available production and financial resources of the enterprise is carried out solely to ensure export activities. In addition, the company as an economic agent will increase the level of its internationalization (export or import actions) in direct proportion to the increase in knowledge of international markets (Amit and Schoemaker, 1993).

Thus, internationalization is a consistent process of commitment in international markets (Figure 3).

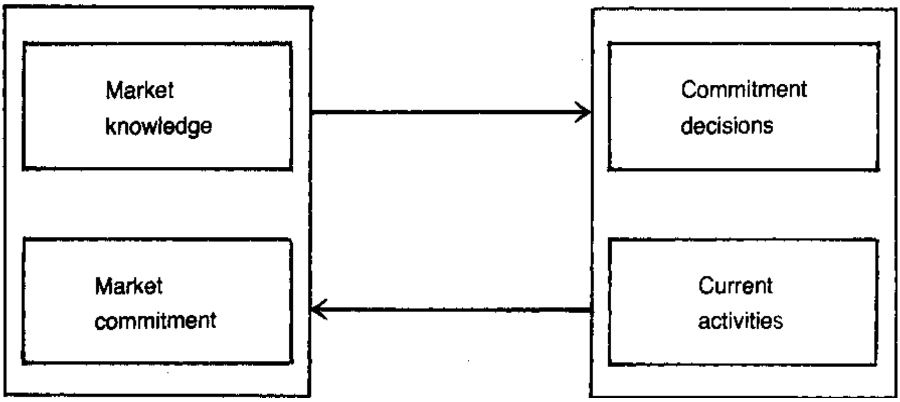

Figure 3. The Process of Internationalization of the Enterprise
Source: Johansson and Vahlne (1977)

The practical application of the Uppsala model is based on the decision-making process and the choice of organizational forms, which depends on many factors, the combination of which complicates the process of evaluation and verification of the model. These factors include either the strengthening of existing internal factors of the model or the containment of exports, the need for information / the process of obtaining it; the choice of a foreign market and access to it (taking into account the psychological distance), the expansion of the firm and marketing strategies (Forsgren and Hagström, 2006).

The network approach is an evolution of the Uppsala model. In it, the authors Johansson and Vahlne (1990) modified the provisions of the model and added the provision that the firm should be online.

Internationalization is defined in terms of connections - in particular through commercial operations that the company conducts with other countries (Vesalainen et al., 1999).

The company's commercial operations with other countries go through the following stages - extension, penetration and integration:

- extension is the first step of the company to join the network;
- penetration refers to the development of the firm's position within the network and the increase in the resource of obligations;
- integration - the last stage when the firm is connected to several national networks and coordinates its activities in each of them.

This approach assumes that the company can be in the network of imports and exports.

The “I-model” as a scenario of enterprise inclusion in international cooperation considers the process of internationalization as a process of adaptation of a new product (Aspelund et al., 2007). According to this model, there are three stages of internationalization:

1) pre – engagement – the firm works only on the national market, plans to be engaged in export; the firm has already attempted to export;
2) the initial phase – the firm exports irregularly, but has the potential to make

this type of activity regular;

3) the advanced phase – the company constantly exports and has foreign experience.

This theoretical model considers the process of internationalization only in the direction of exports.

The concept of "resources, competencies and federation" as a separate theoretical basis for international analysis is defined by a series of factors (financial, material) that can be used at different levels. Agndal and Chetty (2007) describe this model as the concept of federation – is a process of internationalization, which requires the mobilization of all resources and competencies of the firm.

At the same time, resources and competencies are evolving, and are associated with the following characteristics:

- characteristics of the firm;
- management characteristics – attitudes and perceptions;
- external characteristics – market, technology, suppliers, buyers, competitors – can be summarized by the term "milieu".

Resources and competencies can be used to maintain the preferences of the owners (experience, structure, position of the firm), local advantages (productive resources, information) and / or internationalization (low cost of changing the decision on domestic / international activities of the firm).

Internationalization is seen as the result of a process of combining different sets of resources and competencies directly by SMEs themselves.

In addition, Etemad (2005) describes resources and competencies are important both before the start of the internationalization process (acceleration of the process of entering international markets) and in its process (increase in the volume of international activities, suspension of international activities). In the final stage, resources and competencies influence the firm's decisions at the strategic, tactical and operational levels.

This model does not emphasize the vector of the company only on exports - the company is free to choose the direction given the available competencies and resources.

Despite the existing internationalization strategies, enterprises face certain barriers to the export activities of SMEs (Table 1).

Table 1. Barriers to the Export Activities of SMEs

Export	
Micro level	**Macro level**
Difficulties in selecting international partners for the implementation of foreign economic activity; Weakness of export departments of enterprises themselves; Lack / limited experience of international activities Lack of information on foreign markets Difficulty / high cost in forming a competitive advantage in the international market Insufficient capital to start / stimulate the international activity of the enterprise	Political instability Imperfection of trade regulation institutions

The basis for the successful implementation of policies in the field of assistance or assistance to certain types of economic agents is based on economic theory.

The EU has developed the following global solutions to the problems of internationalization for the SME sector:

• Support for innovation to stimulate internationalization – given the high innovative potential of SMEs, as well as the fact that competition in international markets determines the level of competitiveness of goods / services - this area is one of the most relevant in the field of SME support.

• Focusing not only on export activities, but also on imports – the above models show a wide range of theoretical concepts on how the company can be internationalized.

• Promoting e-commerce.

In general, for the successful operation of SMEs in the internationalization process, the following conditions must be met (Figure 4).

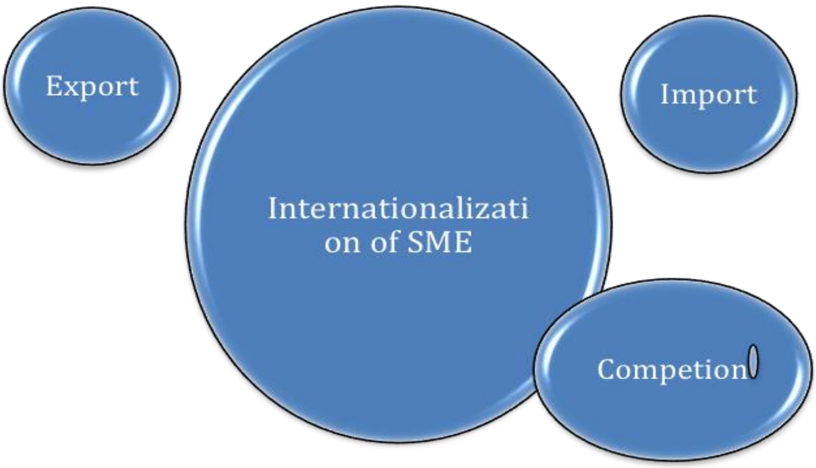

Figure 4. Theoretical Outline of Internationalization of the Enterprise

Source: developed by the authors based on Aspelund et al. (2007), Johanson and Vahlne (1977), Wernefelt, (1984)

Conclusions

At the present stage of development of the global economic system, the process of internationalization of the enterprise is indisputably necessary – one way or another the sequence of actions of the entity to enter the international market (export activity) or compete with foreign counterparts in the national market (import activity) is a reality

The process of internationalization is accompanied and has the following features:

1) firstly, the company must assess its own resources (production, financial, etc.) in order to choose its own scenario of internationalization;
2) the enterprise participating in the process of internationalization goes from indirect export of own goods / services to the international market to participation in the international production network, where it is one of the production units;

3) I Model may be relevant for Ukrainian SMEs – 3 stages of export activities involve not only the learning process of the enterprise, but also the overall increase in the level of competitiveness of products in the international market through each stage;
4) the concept of "resources, competencies and federation", Uppsala model, network approach are more relevant for enterprises in developed countries – a common market, clearly defined legal framework, transparent customs tariffs and certification procedures make it much easier for companies to export / import.

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