



# Strategy matters

Agencies backing the international expansion of SMEs need to sharpen their tools.

Small- and medium-sized enterprises adopt diverse strategies to secure success in global markets and will benefit if organizations dedicated to helping them offer customized support.

# “Support agencies need to orient squarely behind a firm’s own internationalization strategy.”

Governments are keenly aware of the contribution small- and medium-sized enterprises can make to enhancing market integration in the EU and improving its global performance.

But research suggests that institutional support is not yet responding fully to the diverse needs of SMEs with ambitions to succeed in global markets.

Jonas Onkelinx and Leo Sleuwaegen examine companies in Flanders and identify the need for an approach going beyond a traditional emphasis on export promotion to take in the significant variation in the strategies of SMEs.

“Determinants of Successful Internationalization by SMEs in Flanders” builds a comprehensive profile of SMEs, identifies what it takes for them to succeed in foreign markets, and assesses whether support agencies meet their needs.

The report has important implications for managers of internationalizing firms and makes valuable recommendations for policymakers that suggest they need to orient agencies squarely behind a firm’s own internationalization strategy.

## LOCAL HEROES: SMEs in the global economy

SMEs are an important engine of global growth and more than 19 million of them are active in 19 European countries. In recent years, they have created 80% of the new jobs in the EU.

They are key contributors to innovation and export and they are increasingly active internationally, bringing considerable benefits to the home market.

German SMEs, for example, are export and innovation champions – realizing about 40% of exports and spending 5% of turnover on research and development.

Yet European SMEs are less productive and grow more slowly than those in the United States and, even today, most have no international activities.

In Belgium research reveals that SMEs are increasingly involved in international markets and optimistic about future export growth. Belgian SMEs are more internationally oriented than their European counterparts and the country has the highest percentage of SMEs with foreign subsidiaries or joint ventures generating income in Europe.

In Flanders, SMEs comprise more than 99% of all firms and internationalization is more common than in other regions of Belgium. Up to 47% of Flanders SMEs in manufacturing industries internationalized through import, export or both.

## INTERNATIONALIZATION: motives and barriers

Globalization has created new opportunities for SMEs yet many are not active outside their home market and have no intention of going international.

When SMEs do internationalize, they may do so for internal reasons – such as available production capacity, unsold inventory or economies of scale – or because of external factors such as foreign regulations, value chain advantages and export promotion programmes.

Others proactively search for opportunities outside their home market or go abroad in reaction to a changing market environment.

Yet despite the benefits of European integration, SMEs still face obstacles to going international. Increased risk and competition in foreign markets and entry barriers may prevent many from going abroad, and overcoming these may be beyond their resources.

Structural handicaps to internationalization such as limited access to finance and country specific factors such as a lack of specialization are particularly obstructive, and export barriers make doing business more difficult.

## STRATEGIES: sprinklers and waterfalls

There are many varieties of SMEs from those that operate only in their home markets or source inputs abroad but sell at home, to those that use domestic inputs but sell in many countries, and those that are fully international – the most common – sourcing from multiple countries and selling globally.

The crucial strategic choices they make when internationalizing are influenced by timing, resources, and the market environment.

A traditional perspective links the extent of a firm’s internationalization to its size, age and experience, but there is increasing evidence of firms that are international from birth.

Early internationalization enables firms to capture market share fast and may be necessary when product lifecycles are short. Delayed internationalization, by contrast, may promise higher productivity and a stronger competitive position.

Companies also internationalize in different ways: import, off-shoring, export, alliances, licensing, franchising, joint ventures or subsidiaries through foreign direct investment.

Exporting is a relatively easy path requiring limited investment and low risk, but SMEs face transportation costs, trade barriers and a lack of alignment with foreign sales agents, problems that can often be solved using Foreign Direct Investment (FDI). FDI is high risk, time consuming, offers limited flexibility, and it is crucial to identify the right partner.

Firms also need to decide which countries to penetrate and the sequence and timing of how to do so. A key factor will be the competition: entering before competitors may offer first mover advantages and result in higher long-term international market share.

Two types of strategy, reflecting a trade-off between maximizing sales and minimizing risk, have been compared. Some firms introduce their products simultaneously in global markets, the so-called sprinkler strategy, while others initially focus on the home market before entering foreign markets sequentially, the waterfall strategy.

Global competition is increasingly pushing firms to opt for a sprinkler strategy, but certain conditions may favour a waterfall strategy, which limits investment and lessens risk.

Differences can also be identified between market concentration and spreading strategies, with concentrators – who take aim at only a few key markets – tending to be smaller, more interested in export profitability, and having less favourable expectations of export market share and spreaders being larger, putting less emphasis on export profitability and having more favourable market share expectations.

## INTERACTIONS: success factors

Research into successful internationalization has focused on exports and has identified a broad range of factors contributing to success that include a firm's individual characteristics, sector dynamics, product quality, and managerial dynamism when it comes to foreign markets.

However, all firms share the need for certain skills and knowledge relating to how they plan their involvement in international markets, how they deploy resources and the intelligence they gather about those markets.

Research also shows that resources and capabilities affect the choices an export venture makes about competitive strategy.

Remarkably, factors often associated with an international competitive advantage - design, brand image, innovation, distribution network, product differentiation and adaptation to the foreign market - rarely seem to figure among priorities, and few studies place importance on a firm's use of government export assistance programmes.

## FLANDERS: internationalizing SMEs

To explore the internationalization strategy of SMEs in Flanders, an online questionnaire was distributed in collaboration with the entrepreneurs' organization UNIZO and Flanders Investment and Trade (FIT) to SMEs in manufacturing, utilities and services sectors. This enabled Onkelinx and Sleuwaegen to build a profile of respondents:

- They export (48% goods, 20% services and 18% goods and services) to an average of 30 different markets, but the most important are the Netherlands (26%), Germany and France (both 12%) and the UK (10%).
- They source goods and services mainly from neighbours (46%) and the EU15 (42%).
- On average, firms start importing after approximately 2 years and wait 7 years before first exporting, with the first export outside the EU being after 13 years.
- Foreign sales represent more than 50% of total sales for a third of firms and almost half sell less than 25% abroad.

**Motives:** most of the firms profiled launched their international activities because this was necessary for growth, but some claimed they had to do so to survive or to improve competitiveness.

A large number (45%) had actively searched out customers in foreign markets, while 27% had gone international after responding to an unsolicited order from abroad.

Some 16% of firms have international activities that go beyond import and export, such as collaboration with foreign partners and foreign sales subsidiaries, but foreign production plants and joint ventures are less common.

**Agency support:** in Belgium different federal and regional organizations operate a range of policies supporting internationalization and most SMEs have received help from one or more organizations, but there are uneven levels of awareness about and use of that support.

When it comes to support, entrepreneurs primarily need market research, information about foreign markets and help identifying foreign partners. There is much less of a need for assistance with export formalities and developing international business skills.

But what SMEs actually receive does not always match this need, and in some areas, there is a large gap between the number of SMEs that need help and those that get it. In particular, there is a lack of provision in identifying business partners and market research and in providing information on foreign markets.

**Niche players:** many SMEs in Flanders still internationalize in stages, beginning after years of operating domestically, but some do so rapidly after inception, often in their first year.

These often operate in niche markets, opt for a rapid international expansion after start-up and are present in a larger number of markets across the globe.

Niche players are more proactive internationalizers and do so in diverse ways, including foreign sales subsidiaries, production plants, joint ventures and licences. They also spend more on R&D and are more optimistic about international growth.

## IMPLICATIONS: taking aim

Firms that are born global challenge the traditional view of a small company branching out in stages that implies that an SME's size, age and experience is directly related to how it internationalizes.

For start-ups in high-technology industries, the question is not whether the firm will internationalize – but when. Evidence from Belgian SMEs shows that export is still more common among older firms but the number of rapidly internationalizing SMEs is increasing.

Given this diversity, policymakers designing support schemes for SMEs need to fashion these to their specific requirements deriving from the decisions managers make about strategy: offering the right type of help to the right firms is crucial for support to be effective.

Both niche players and those in mass markets have a common need for support with financing or subsidies, market research and information on foreign markets, and require help with export formalities, but the specific needs of each group differ:

Niche players need:

- information about legislation in foreign markets;
- to develop or adapt products for foreign markets;
- to develop international business skills.

Whereas SMEs operating in mass markets need:

- to identify foreign partners;
- promotional support;
- networking with entrepreneurs that have international activities.

## POLICIES: recommendations

Policymakers are keenly aware of the role SMEs can play in propelling market integration in Europe and improving the EU's global performance, yet research has revealed that about 45% of SMEs in Europe have never considered internationalization.

The European Commission has identified areas essential for the internationalization of SMEs that include a need to raise awareness of its value and promote networks and cross-border co-operation, and for good information, human resources' development programmes, financial aid and individualized support.

However, many government support programmes focus on promoting export through credits, trade missions and exhibitions, yet such programmes are typically low on the priorities of SMEs themselves which are increasingly adopting diverse forms of internationalization and combinations and collaborations. Some countries combine innovation and internationalization support, although many such programmes also fail to meet SME needs.

Therefore, institutions dedicated to supporting internationalizing SMEs ideally should:

- provide customized help aligned to a firm's specific strategy by, say, bringing supporting agencies in line with a well-developed internationalization plan.
- help SMEs that concentrate on a few markets stay competitive in those that are key to their well being by, for example, locating partners and subsidiary development.
- help SMEs that spread their activities across markets find new opportunities allowing them to exploit economies of scale and diversify risk. Managers of these firms need support in identifying markets where there is demand, and in learning how to meet it.
- reduce administrative burdens by, for example, cutting red tape, harmonizing regulations and easing the effort required in dealing with official administration.
- actively support internationalization through subsidies or reduced social security contributions.
- avoid delays and uncertainty in responding to requests for support: one-stop shops offer a particularly effective way of saving time and costs for users.

### Reference:

*Determinants of Successful Internationalization by SMEs in Flanders*, by Jonas Onkelinx and Leo Sleuwaegen  
(Flanders DC Knowledge Centre at Vlerick Business School)