

# Factors Influencing The Internationalization Of Small And Medium Size Enterprises

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## ABSTRACT

*This study explores the factors influencing the internationalization of small and medium enterprises located in the Eastern Townships of Quebec, Canada. Four major factors emerged from the data to explain the internationalization. The four factors include owner manager's international orientation, globalisation of the firm's industry structure, established international networks, and foreign market potential. Successful firms were found to have owner managers with an international orientation and established international networks.*

**Keywords:** Internationalization, small and medium size enterprises, Eastern Township

## INTRODUCTION

Recognizing the increasing role played by small and medium size enterprises (SME) in economic development and job creation the past two decades have seen a growing interest in the study of international operations of small and medium size enterprises (Ruzzier et al, 2006; Lu and Beamish 2006). However, most of the theories of international business have mainly been focused on the internationalisation of multinational enterprises. It was not until the publication of McDougall and Oviatt's (1994) article titled "Towards a theory of international business studies" that scholars began addressing aspects of international business to explain the internationalisation of small and medium size enterprises or international entrepreneurship. On the other hand, more recent studies (Sharma, 2004, Cerrato, 2007) have suggested that SME internationalisation may be influenced by location and thus calling for more research on the study of internationalization from different national environments. The aim of this paper is to start filling in this gap by exploring the factors influencing the internationalisation of SMEs located in the Eastern Townships of Canada.

## LITERATURE REVIEW AND HYPOTHESIS

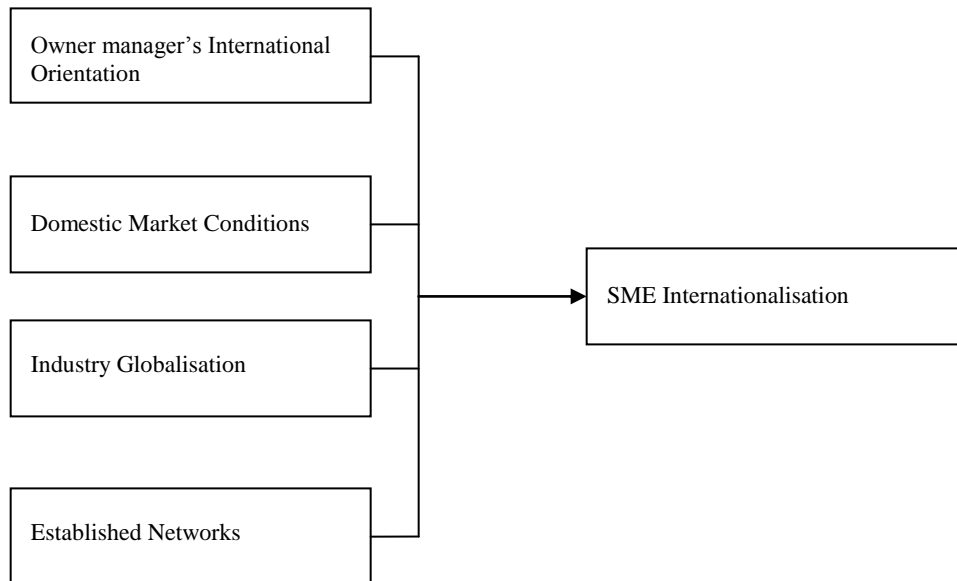
Early theories explaining the internationalisation of firms have their roots from economics starting with Hymer's (1976) theory of firm specific advantage which set out to explain what enables firms to carry out international operations. This theory suggested that due to the disadvantages that firms face in foreign markets they can only succeed if they have some superior advantage over local foreign firms. Building on Hymer's work the internalisation theory was used to explain how multinational enterprises are created to overcome market imperfections Rugman (1981) and the Eclectic framework was developed by Dunning (1981) to build upon the existing theory and incorporate the role of location advantage to determine the location of multinational enterprise. Dunning (1993) articulated the major motives for international operations as resource seeking, market seeking and efficiency seeking. However, these theories have mainly been used to explain the internationalisation of large multinational enterprises.

The most popular theory of internationalisation is the Uppsala internationalisation process school that suggests the internationalisation process as a gradual incremental process consisting of a series of stages of increasing involvement in international operations as the company gains international experience (Welch and Loustarien, 1993, 156). This school looks at internationalisation as a learning process where as the firm gains international experience it reduces the risks of operating in foreign environment and can safely increase its resource commitment. However, with the emergence of the born-global firms that emerged with advent of increasing globalisation, the Uppsala internationalisation theory has lost its explanatory power. The recent process of

globalization driven by the development of information technology, falling trade barriers leading to an increasingly interconnected and interrelated world has rapidly reduced the psychic and geographic distance between countries which undermines the key promises of the Uppsala internationalisation school.

A complement to the internationalisation theory is the network approach (Johanson and Mattson, 1998) that uses the social exchange theory to explain the internationalisation process of firms. By building relationships with other firms in the industry such as suppliers, competitors and customers the firm is able to gain access to assets that overcome the firm’s resource constraints. These relationships are therefore considered as market assets that compliment to the firms lack of international knowledge that was earlier developed by the Uppsala school. However, the network approach has been criticised for its lack of incorporating strategic aspects of internationalisation (Rutihinda, 1996).

A promising theory of internationalisation is the Resource-based Internationalisation frame-work (Rutihinda, 1996; Ahokangas, 1998) that builds on the resource-based view of the firm to incorporate strategic management aspects to the internationalisation processes. Building upon the resource-based internationalisation process this study uses the framework illustrated in Figure 1 to explain the internationalisation of SMEs from the Eastern Townships.



**Figure 1: Drivers of SME Internationalisation**

The main distinction of small and medium size enterprises is the central role played by the owner manager in making strategic decisions. Unlike large firms that have a large pool of professionals employed to address specialised tasks, small and medium size enterprises are highly dependant on the capabilities of their owner managers. A great deal of the entrepreneurship and small business literature have identified the crucial role played by the owner manager is determining the strategic direction of the business. Management’s limitations such as risk aversion or limited knowledge about foreign opportunities can limit the firm’s ability to pursue international operations. The initiative to proactively pursue international business opportunities will highly depend on the SMEs owner manager’s international vision and exposure to international market opportunities. A Manager’s positive perception of foreign markets is likely to commit more resources towards activities with the aim of stimulating growth into international markets.

**H1:** SMEs with owner managers with an international orientation are more likely to proactively undertake international operations and succeed.

The domestic environment has been considered in the international marketing literature as providing an environment that would trigger companies to pursue international opportunities. When the domestic market is saturated or when competition is too intensive firms are likely to see growth by searching for opportunities outside their home market. As the domestic competition intensifies companies are driven to become more innovative and efficient which raises their capacity to compete. Conducive domestic market conditions such as well developed supporting institutions including export promotion agencies and other government incentives (access to low interest loans) can trigger local SMEs to search for market opportunities.

**H2:** SMEs facing high level of domestic competition are more likely to proactively engage in international operations and succeed.

Global industry structure refers to the extent to which a firm’s industry has been more global players in the market. Porter (1990) distinguishes global industries as those industries in where competition takes place among firms located in different countries. Small and medium size firms in global industries find themselves facing competition from foreign firms that operate in their local markets. This interaction of local firms with global players is likely to trigger local SMEs to seek opportunities in foreign markets within the same industry.

**H3:** SMEs operating in globalised industries are more likely to proactively engage in international operations and succeed.

The Network theory suggests that a firm’s internationalisation is influenced by its position and relationships in the industrial network. A firm’s relationships with other firms in the market place can contribute to its internationalisation process. As the firm takes advantage of its established relationships in the industrial network the SME may be able to overcome its resource constraints by using its partner’s resources. Established international networks are likely to encourage small and medium size firms to pursue international operations.

**H4:** Firms that have more established international contacts are more likely to succeed in international markets.

**METHODOLOGY**

Data was collected through a survey of exporting small and medium size firms located in the Eastern Townships. The study sample was drawn from a list of registered exporters from the Eastern Townships. From this list, only exporting firms with less than 500 employees were included in the contact list. A contact list of 275 SME exporters located in the Eastern Townships was identified where all 275 SMEs were first contacted by phone and later a questionnaire was sent to all respondent who accepted to take part in this survey. Out of that list, ninety respondents refused to participate in this study for various reasons leaving a list of 188 firms from which constant contacts were made to encourage their response. Finally, after all the means to solicit responses were exhausted, only 71 positively responded to the questionnaire. However, after scrutiny of the responses only 64 cases were found eligible for further analysis which represents a response rate of 23 percent of the original targeted population. Table1 below provides the characteristics of the firms in the sample. Thirty eight percent of the firms in the sample were in the manufacturing of industrial goods while 25 percent were in the consumer durable industries and the rest were in the manufacturing of non-durables including health care and pharmaceuticals.

**Table 1: Respondent by Industry**

<b>Industry</b>	<b>N</b>	<b>Percent</b>
Manufacturing consumer non-durables	5	8
Manufacturing consumer durables	16	25
Manufacturing Industrial goods	24	38
Health care and Pharmaceutical	2	3
Telecommunications and IT	12	19
Professional Services	4	6
Other	1	2
<b>Total</b>	<b>64</b>	<b>100</b>

Examining the sample by size of respondents in terms of employees and sales turnover, we find that most of firms in the sample have more activities outside the Eastern Township with most of their sales taking place in the USA and other parts of Canada. This reflects the Eastern Townships’ location advantage of being closely located to the USA borders along with the long historical ties between communities of both sides of the border.

**Table 2: Firm Size by Location in Number of Employee and Sales Turnover**

	<b>Eastern Townships</b>	<b>Other Canada</b>	<b>USA</b>	<b>Other Countries</b>
<i>No of Employee</i>				
<b>Under 20 employees</b>	34	59	60	11
<b>21 to 50 employees</b>	31	7	7	2
<b>51-500 employees</b>	30	3	61	0
<i>Sales in Canadian Dollars</i>				
<b>Less than \$1million</b>	27	20	20	6
<b>\$1 to 10 million</b>	33	37	30	9
<b>More than 10 million</b>	5	6	13	3

The survey’s main source of data was through a structured interview. Measures used in this study have been drawn from similar empirical studies on SME internationalisation. Since the Eastern Townships are bilingual, to ensure adequate cooperation and accuracy of the data the questionnaires were first prepared in English then translated into French and from French into English again using independent translators. A bilingual approach was used to contact the respondents, respondents who preferred English were provided with an English questionnaire and those that preferred French received a French questionnaire. To facilitate the interpretation of the survey findings an in-depth case study from the successful exporting SME was used.

**ANALYSIS**

Measures used to explore the reasons that prompted SMEs to export are as shown in Table 3., From the results of the survey we find the major reasons that drove exports from Esterie to include International vision of managers, large proportion of potential foreign customers, identification of international opportunity, personal contacts, and to improve domestic sales.

**Table3: Export Driver Variables**

	<b>Mean</b>	<b>Std. Deviation</b>	<b>N</b>
<b>International vision of managers</b>	6.79	2.812	63
<b>Large proportion of potential foreign customers</b>	6.56	2.717	63
<b>International competitive nature of Industry</b>	6.33	2.700	63
<b>Identification of international opportunity</b>	6.06	2.633	63
<b>Personal knowledge &amp; contacts with int. customers</b>	6.06	2.602	63
<b>Improve domestic sales</b>	6.03	3.005	63
<b>Desire to be an international market leader</b>	5.90	3.151	63
<b>International experience of managers</b>	5.67	2.857	63
<b>Small domestic market</b>	5.63	2.824	63
<b>International sales needed for economies of scale</b>	4.78	2.937	63
<b>Need to respond to competitors initiatives</b>	4.37	2.864	63
<b>Pressure from firm's customers</b>	4.37	2.858	63
<b>Advances in IT have reduced international barriers</b>	4.16	2.963	63
<b>Increased homogeneity of international markets</b>	4.08	2.726	63
<b>Desire to capitalize on proprietary technology</b>	3.98	2.948	63
<b>Avoidance of intense domestic competition</b>	3.95	2.581	63
<b>High R&amp;D costs necessitated international sales</b>	3.84	2.841	63
<b>Influence from firm's business partners</b>	3.62	2.802	63
<b>Short product life cycles necessitated int. sales</b>	3.38	2.921	63
<b>Advice from government agencies</b>	3.10	2.613	63
<b>Need to obtain foreign financing</b>	2.59	2.325	63

Since export drivers are complex phenomena, to identify the underlying constructs of export drivers, the variables listed in Table 3 were subject to factor analysis. A correlation matrix of all the above variables was computed and KMO measure of sampling adequacy was used to examine the correlation matrix. The KMO measure of sampling adequacy was 0.73 suggesting that we can comfortably proceed with the factor analysis. The variables were then extracted using principal component analysis. As seen in Table 4 four factors emerged with eigen values greater than 1. These four factors explained 67 percent of the total variance.

**Table 4: Explained Variance**

	<b>Initial Eigenvalues</b>	<b>% of Variance</b>	<b>Cumulative %</b>
<b>International Vision of Managers</b>	34.805	34.805	34.805
<b>Large Proportion of Potential Foreign Customers</b>	11.156	11.156	45.961
<b>Int. &amp; Comp. Nature of Industry</b>	8.702	8.702	54.663
<b>Identification of International opportunity</b>	6.541	6.541	61.204
<b>International experience of Managers</b>	5.550	5.550	66.754
<b>Desire to be an International Market Leader</b>	4.619		
<b>Personal Knowledge &amp; Contacts with Int. Customers</b>	3.793		
<b>International Sales Needed for Economies of Scale</b>	3.733		
<b>Desire to capitalize on proprietary tech.</b>	3.345		
<b>Need to Respond to Competitors Initiatives</b>	3.000		
<b>Improve Domestic Sales</b>	2.566		
<b>Small Domestic Market</b>	2.048		
<b>Advances in IT have have reduced Int. Bus. Barriers</b>	2.005		
<b>High R&amp;D Costs necessitated International Sales</b>	1.814		
<b>Increased Homogeneity of Int. Markets</b>	1.552		
<b>Pressure from Firm's Customers</b>	1.425		
<b>Influence from Firm's Business Partners</b>	.932		
<b>Short Product Life Cycles Necessitated Int. Sales</b>	.889		
<b>Advice from Government Agencies</b>	.661		
<b>Avoidance of intense domestic competition</b>	.523		
<b>Need to Obtain Foreign Financing</b>	.340		

Table 5 below shows the results of the rotated four factor solution. From the factor loadings we can interpret the factors as Owner manager’s international orientation, SMEs industry globalisation, domestic industry condition, SMEs established networks, and foreign market potential, as the main drivers of SME internationalisation. To determine the reliability of the factors loadings the items in each factor were tested using Cronbach alpha. Results show all the four factors with Cronbach alpha greater than 0.60.

**Table 5: Export Drivers**

	<b>International Orientation</b>	<b>Industry Globalization</b>	<b>Domestic Industry Condition</b>	<b>International Networks</b>	<b>Foreign Market Potential</b>
International experience of Managers	.823				
International Vision of Managers	.818				
Desire to be an International Market Leader	.776				
Int. & Comp. Nature of Industry	.703				
High R&D Costs necessitated International Sales		.811			
Increased Homogeneity of Int. Markets		.789			
Need to Respond to Competitors Initiatives		.539			
Advances in IT have reduced Int. Bus. Barriers		.535			
International Sales Needed for Economies of Scale		.527			
Desire to capitalize on proprietary tech.		.441			
Avoidance of intense domestic competition			.770		
Improve Domestic Sales			.766		
Short Product Life Cycles Necessitated Int. Sales			.713		
Need to Obtain Foreign Financing			.582		
Advice from Government Agencies				.820	
Personal Knowledge & Contacts with Int. Customers				.737	
Identification of International opportunity				.655	
Pressure from Firm's Customers					
Influence from Firm's Business Partners					
Large Proportion of Potential Foreign Customers					.703
Small Domestic Market					.702
<i>Cronbach Alpha</i>	.845	.806	0.815	0.757	0.628

Using the above same procedure, measures for SME performance were subject to factor analysis and the results are as seen in Tables 6 and Table 7. Two factors emerged with eigen values greater than one. These factors explained 80 percent of the total variance.

**Table 6: Firm Performance Measures**

	<b>Communalities</b>	<b>Eigen Values</b>	<b>% of Variance</b>	<b>Cumulative %</b>
Sales Level	.887	4.163	59.471	59.471
Sales Growth Rate	.879	1.419	20.274	79.745
Cash Flow	.515			
Gross Profit	.847			
Net Profit from Operations	.823			
Return on Investment	.841			
Ability to Fund Business Growth from Profits	.790			

Based on the composition of variables in each factor we can confidently suggest that the first factor measures the firm's profitability while the second factor measures the firm's sales performance.

**Table 7: Performance Measures**

	<b>Profitability</b>	<b>Sales</b>
Ability to Fund Business Growth from Profits	.876	.152
Return on Investment	.869	.293
Gross Profit	.851	.351
Net Profit from Operations	.832	.360
Cash Flow	.705	-.136
Level of Sales	.159	.928
Sales Growth Rate	.157	.924
<i>Cronbach Alpha</i>	.905	.902

In order to determine the relationships between internationalisation drivers and firms performance, the measures were subject to cluster analysis. Results of the two cluster solution are shown in Table 8.

**Table 8: Export Drivers and Firm Performance**

	<b>Successful</b>	<b>Unsuccessful</b>	<b>Significance</b>
<b>International Orientation</b>	.53193	-.71725	.000
<b>Industry globalization</b>	.11495	-.10445	.394
<b>Domestic Competition</b>	.24388	-.31021	.031
<b>International Networks</b>	.17645	-.25718	.095
<b>Foreign Market Potential</b>	-.15615	.22754	.140
<b>Sales Performance</b>	.51028	-.71153	.000
<b>Number of Cases</b>	36	26	

The first group of clusters consists of 36 firms that can be described as the successful firms with a favourable sales growth. Firms in this cluster were driven by managers with a very strong international orientation. These firms were also driven to internationalise by their already established business networks. Domestic industry structure also played an important role in successful firms. However, results show no significant relationships between the firms’ industry globalisation and firm performance. There is also no significant relationship between SME’s foreign market potential and performance. These results support

**THE CASE A SUCCESSFUL SME IN THE BEVERAGE INDUSTRY**

The above SME export drivers can be illustrated by the internationalization process of a small family-owned SME located on the slopes of in the Eastern Township exporting a high-end beverage. This company is currently involved in 20 different countries among of which include the U.S, France, Italy, Japan, Hong Kong, China and Korea. Activities outside Canada are mainly managed through foreign distributor who deals with the upper-end market segment in this respective industry. The product is also sold by duty free agents in international airports.

The company operated for only two years since its inception in Canada before it decided to export. One of the owners had previously worked in several companies known for selling branded products in international markets. According to the owners, the domestic market was still growing with untapped growth potential but the entrepreneurial mindset of the company owners triggered them to realise the value of gaining a grip in a foreign market as early as possible. As described by the owner the mission of the company is to be the world leader in this special market niche.

According to the owner manager the product is at the beginning of its life cycle, but the pace of growth is fast as markets are growing exponentially mainly due to globalisation. The global demand of the product enabled the owners to quickly take advantage of the demand gap and expand their market base globally starting with the duty free market outlets at airports.

Although this product is fairly new in the global markets, in the home market other competitors have started to imitate the product but with relatively poor quality. This domestic competition has emerged as a result of the company’s rapid growth in Quebec where the product has become known and is in high demand. The company’s biggest challenge (according to the owner) is to meet the growing demand. Since this product is differentiated by its unique product production process that is tied to the Easter Township location the product meets very little competition in international markets. Even for producers in the same location the products unique taste and the now strong brand name attached to this product makes it hard for competitors to copy.

Most of the value chain activities are carried out within the Eastern townships and its exports take place through a high end specialised distributor. As the pioneer of this product this company was able to easily gain market access and was also able to lock-up the best distributor to partner with in foreign markets. The owner met the distributor in an international trade fair where both parties came to developed contacts and relationships.

The success of this SME can be explained by its management's entrepreneurial and international orientation, its favourable domestic market conditions, and established networks. Currently this SME is the leader in its product market. In Quebec the company has done "well above expectations". Largely this can be attributed to good relationship that has been established with the local distributors. Having a newly created SME become the market leader in this industry is amazing. Given that the industry in Canada is over 4.2 billion (Statcan 2006), the threat of having one of the main industry players make the transition into this product is ever present. However it is not surprising that there has been success in this industry, given the fact that the Canadian industry had the 11th highest growth rate among 215 industry groups between 1997 and 2001. This growth in this industry was mainly driven by local demand, where as the foreign demand of related product category was 88% of total industry exports (Statcan 2006).

## CONCLUSION

Using factor analysis this study has explored the factors influencing the internationalisation of small and medium size firms located in the Canadian Eastern Townships (Estrie). Four major factors have emerged from the data to explain the internationalisation of these SMEs. These factors include SMEs owner manager's international orientation, globalisation of SME's industry, SME's established international networks, and foreign market potential. Successful firms were also found to have owner managers with an international orientation with established international contacts. This study was limited by its relatively small sample size. Future studies can replicate this study by using larger samples. For policy makers this study has identified the role of a conducive domestic environment and an international orientation as important drivers of SMEs international success. Exposing SMEs to more international market opportunities can stimulate SME export growth. For SME managers this study suggests a more proactive approach to internationalisation that guarantee successful international operations through establishing international networks.

## AUTHOR INFORMATION

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