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## **THE ROLE AND SIGNIFICANCE OF THE PROCESS OF INTERNATIONALIZATION OF THE SMALL AND MEDIUM ENTERPRISES**

### **Abstract**

The speed with which changes occur in the international business environment requires participants to think globally and act quickly. In such an ambient, the companies can't to be successful on the long run if they are focused on building a business model to only operate on the domestic market, because in that case would be faced with the risk of disappearing or being undertaken by entrepreneur-oriented firms. Indeed, the internationalization of business is a necessary process and how this process starts early, it will be more possible firms to grow faster and achieve long-term development. The major role in the global economy has multinational companies (MNC). But, in the contemporary terms under the influence of rapid technological development (development of information and communication technology, the biotechnology and etc.) is facilitates the accessing and opportunity for the internalization of the business of the small and medium enterprises.

Benefits from the internationalization of business are multiple, but at the same time this process is followed by the a series of barriers, particularly highlighted for small and medium enterprises such as: lack of knowledge and skills for entering in new foreign markets, lack of sufficient financial resources to support internationalization of the business and etc., that along greater engagement of the internal factors of influence, in the same time imposes the need for greater government support of SME in order to encourage the decision for internationalization of the business.

**Key words:** Globalization; internalization; small and medium enterprises; benefits; treats.

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## **1. THE NEED AND NECESSITY FOR INTERNATIONALIZATION OF THE SME**

Subject of research in the paper present the small and medium enterprises in order to determine the benefits that they realize from internationalization, and the impact of the factors that affect this process.

Modern economics has the character of the global economy, which means possibility for global production and global market. Major role in the global economy has the multinational companies. But in modern conditions, rapid technological development (development of information and communication technology, biotechnology etc.) facilitates the access and opportunity for internationalization of the small and medium enterprises. Benefits of the internationalization of business are multiple, but at the same time this process is faced by a series of barriers, particularly highlighted for small and medium enterprises, such as lack of knowledge and skills for entering in new foreign markets, lack of sufficient financial resources to support internationalization of business and the like.

Sector of small and medium enterprises is one of the key factors for the development of any economy, developed or less developed large or small economy. Hence, the need to support and development this sector in the national economy is very important, that in same time understands the support for their internationalization too, in order to overcome the factors that limit such process.

SME development is imposed as one of the imperatives of development of the Macedonian economy, because the development of this sector in the same time provides faster development of the overall economy. Macedonian economy is a small economy with little market for operating of the domestic enterprises. Hence, internationalization of the business of the enterprises presents a very important factor for their performance and development, including the SME's.

The theory of the growth models of the firms indicates the factors that affecting the growth of firms, and the degree of influence of these factors on the growth. One of these factors presents size of the firm. In analysis of the conditionality between the size of the firm and the rate of growth, it is realized that small firms grow faster than large firms, as the new firms than companies that exists longer period.

Generally, there are two ways to realize the growth of the firm, internal and external growth. External growth is accomplished through the internationalization of the operations of companies or through the export or investment activities beyond own national economy. It should be noted that although internationalization is primarily a feature of large companies, in terms of globalization, when the local market is open for foreign firms it creates direct competition on the domestic market, which exercised influence over the operations of domestic firms, including the domestic small and medium firms. In this way even small businesses primarily located locally, again faced with foreign competition, that forces them to take appropriate action in

order to be in possible to compete with foreign firms and to survive in the market. Also, although small firms operate primarily on the domestic local market under the impact of globalization they do not remain outside of the global market, but contrary they are included as part of global supply chains.<sup>1)</sup>

Global expansion of firms regardless of their size, it allows of the firms to increase their profitability, if the opportunities for growth and development of the domestic market are already used. Companies that operate across national boundaries are able to:<sup>2)</sup>

1. To expand the market for its products by selling those products in international markets;
2. To realize economies of location, through the dispersion of the activities to locations worldwide, where they can be performed most efficiently and most effectively;
3. To reduce costs through the effect of learning (through repetition of activities) and economy of scale (increased volume of production);
4. To make more profit with dissemination of knowledge and skills acquired in foreign affiliates through other parts of the firm.

Companies that act on the world market usually are faced by two types of factors that make pressure on the process of the formulation of the strategy for entering in the foreign market:

- Pressure to reduce costs;
- Pressure to response to the requirements at the local level.

Such competitive pressures according to their nature, to the firms set to face with contradictory requirements. Namely, the firm to respond to pressures to reduce costs; it should try to minimize their unit costs. But on the other hand, pressure for local reaction may require the firm to differentiate its production according to specifics on the local level, so as would be possible to meet various demands of consumers, business practices, distribution channels, government policies, etc., among different market. The need for differentiation of product offer does not allow production standardization that would be cause to increase costs, and consequently to increase the prices of products and services.

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<sup>1)</sup> Dickens D., Phils M.(2010): Entrepreneurship and small firms, fourth edition, TRI, Skopje, p.206.

<sup>2)</sup> Hill V. L., Charles (2010): International business: competing on the global marketplace, MAGOR, Skopje, p.414.

## **2. ADVANTAGES AND DISADVANTAGES OF THE INTERNATIONALIZATION OF SME**

Contemporary processes of globalization have a great impact on the business of small and medium enterprises. Some companies through internationalization see new opportunities for expansion and growth, and if these enterprises don't have serious problems and obstacles in their adaptation to new circumstances arising from the entering into new business environment, they soon become internationally competitive. But in most cases, increasing economic dependence arising from involvement in international trends and competition leads to new, very serious challenges and threats.

### **2.1. Benefits of the internationalization**

Internationalization of business can be defined as a series of business activities that performance across national borders. It should be noted also, that the internationalization of business is a process that occurs in stages, and that can arise large changes in the enterprise. Internationalization making decision is influenced by multiple factors (conditions) as follows: size of the domestic market, market position and flexibility of the firm, the openness of the domestic economy, the degree of development of the sector in which the company belongs, management skills, etc. However, it is important to emphasize that the process of internationalization of enterprises is closely related to the application of appropriate marketing strategies, or a firm can internationalize their business without to have an adequate marketing concept to perform on the global market. Accepting the global orientation of the firm does not necessarily mean that the company will participate in all world markets, but they can focus their efforts on most promising markets. The global orientation of the company as previously stated is not necessarily related to its size. Much of the enterprises, regardless of their size and location, may become global. The main feature of the global enterprise is locating production factors where growth potential is optimal (using the economics of location).

In the contemporary world, small businesses are dominant in the business activities (more than 95% of the business activities of all countries come from this sector). Such a high share of SMEs in the national economy is the result of several factors that allow SMEs to realize an advantage over the large firms, such as openness, dynamism and innovation, lack of barriers in terms of a hierarchy of decision making, greater flexibility in the decision making, shorter time to respond to consumer needs and market, easier concluding partnerships with companies that are suitable to achieve synergistic business results and etc.

Managers of small and medium enterprises are mainly interested for the direct benefits that the enterprise can realize by the process of internationalization, which simultaneously represent factors that affecting the company's decision to act outside

national borders. As important motives for the internationalization of small and medium enterprises are points out the following:

- having a unique product;
  - achieving technological advantage over the competition;
  - achieving economies of scale and
  - the desire to use potential business opportunities in foreign markets.
- Besides these four basic motives it could be possible to indicate also and other additional motives for internationalization of business such as:

The reduction of domestic demand, that may arise the fear the firms to lose own share of the domestic market;

- saturation of the domestic market and
- enhance the sales of the company beyond national borders.

The revenue that the firms earn additionally from foreign markets undoubtedly provides opportunities for further enterprise growth and development. With the expansion, companies gain access to new technologies and experience in international business, and adopt new skills. Also, through involvement in the international market they set up cooperation with other companies and provide access to new sources of funding.

All the previously mentioned elements can be characterized as the advantages of internationalization of the business of small and medium enterprises, which in turn as it were previously stated enable faster development and growth of SMEs. This is particular importance because the SME sector has a key role in the development of national economies, because its participation in economy is very important according to their participation: in the total number of firms in the economy, in the total employment, in the export activity of the economy and so in the creation of GDP (gross domestic product).<sup>3)</sup>

## **2.2. Weaknesses (barriers) for internationalization**

Despite numerous advantages that internationalization are provided to the companies, in the same time it is accompanied by numerous barriers. The barriers of the internationalization can be seen through the factors that in the same time act as barriers to growth of firms. From this point of view, the theory points out three segments where a possible to occurrence is the limitations of the internationalization:<sup>4)</sup>

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<sup>3)</sup> In 2010 in Republic of Macedonia, the share of the SME's in the total number of the enterprises was 99.7%, or 75.294 SME. It's share in the total employment was over 80 %, while in the export and GDP it's participated with around 50 %.

<sup>4)</sup> Dickens D., Phils M, cited book, p.198.

- management and motivation;
- financial assets and
- market opportunities and structure.

The first type of limitation specifically refers to the lack of managerial skills, possession relatively low qualifications, inability to delegate tasks and obligations, and the need to adopt new managerial skills and techniques in accordance with the needs for growth and development of the firms.

In the literature many authors emphasize the importance of this factor for the success of the internationalization process, emphasizing that knowledge, attitudes and motivation of the entrepreneurs or managers in small and medium enterprises play a crucial role in making decision to internationalize the business. From this aspect, mainly stands out two factors that are necessary for the progress of the company towards internationalization: expectations of management for the benefits of the company's internationalization and their commitment to the process of internationalization.

In the initial stage of internationalization, one of the biggest barriers is a lack of knowledge for the foreign markets. Knowledge that managers possess is determined by their level of education, experience acquired by the operation in the foreign markets, knowledge of foreign languages, and the like. Managers who already work in internationalized small businesses have access to new knowledge, whose knowledge can then be used by other small and medium enterprises in the process of internationalization of their business. Also in the process of internationalization it is necessary the enterprises to develop structures and procedures complementary to their internal resources and capabilities, that is crucial for success of the internationalization of their business. Hence, it is necessary to identify knowledge and skills that are essential for the success of a particular company, and setting an adequate system of transfer of knowledge to the rest of the organization, that means accumulation of knowledge, which plays an essential role in international growth of the companies.

The second type of obstacle concerns to the opportunities for access and use of appropriate sources of funding, access to technology and trained staff. SMEs more than large firms are facing with significant financial problems in the process of internationalization. Initially they have less financial ability to finance their international business operations. In the same time also, because of its lower creditworthiness, financing of the small and medium companies was seen by financial intermediaries as a highly risky investment. Therefore, before to approve each loan, they require additional guarantees, whose value can often, be greater than the amount of the loan, by one side, and by the other side the loans are approved with higher interest rates compared to loans that are approved to the large firms. This is especially pronounced in the first few years of operation of the enterprise.

The third type of restriction concerns to the opportunities for the market growth, the size and dynamic of the sales, the degree of market segmentation and opportunities for cooperation and association.

Additionally, barriers in the process of the internationalization of SMEs and hence their non-participation in international business can be divided into two groups:

- 1) those who over stress internal and external obstacles, or barriers for internationalization
- 2) those who on the internationalization don't look like a way and opportunity to develop own business in future.

The second group of firms believes that the demand on the domestic market will last longer period simply have no ambition for growth.

Based on the earlier said that SMEs are perceived exercise benefits range from internationalization, but face several problems in implementing this process because often management or Contractors are not defined for such a qualitative change in its business.

### **3. INTERNATIONALIZATION OF SME IN EUROPEAN COUNTRIES**

In this article to considerate the extent of internationalization of SMEs are used the data of the research conducted by the European Commission in 2009, on the 9,480 SMEs in 33 European countries of which 27 countries are in European Union and 6 countries outside the EU (Croatia, Ireland, Liechtenstein, Macedonia, Norway and Turkey).

Because, the issue of internationalization of firms is very complex issue, in this section is stressed only some aspects of this process based on the data obtained from the previously mentioned research.

When analyzing the different models of internationalization of the business of SMEs between 2006 and 2008, which includes exports, imports, FDI, technological cooperation, to be subcontractor of a foreign company and to be foreign subcontractor, on the basis of the data is found that 44% of SMEs are internationalized, whereas most of the internationalization of SMEs is based on imports (29%) and least in respect of FDI (2%), see Table 1.

According to the data from the Table 1 it is possible to perceive also the degree of dependence between internationalization firms and the size of the firm. Namely, according to data is seen that 73% of medium enterprises are the least internationalized based on one of the six activities for internationalization of business (export,

Table 1

<b>PERCENTAGE OF SMES WITH INTERNATIONAL BUSINESS ACTIVITIES IN 2006-2008, BY ENTERPRISE SIZE</b>				
<b>Mode of internationalization</b>	<b>Micro</b>	<b>Small</b>	<b>Mediumsized</b>	<b>Total</b>
<b>Percentage of all SMEs</b>				
SME with direct exports	24%	38%	53%	<b>26%</b>
SME with direct imports	28%	39%	55%	<b>28%</b>
SME has invested abroad	2%	6%	16%	<b>2%</b>
SME with technological cooperation with enterprises abroad	7%	12%	22%	<b>7%</b>
SME has been a subcontractor to a foreign main contractor	7%	11%	17%	<b>8%</b>
SME had foreign subcontractors	7%	12%	16%	<b>7%</b>
SMEs with at least one of these 6 international activities	43%	58%	73%	<b>44%</b>
<b>Total N, unweighted</b>	<b>3253</b>	<b>3260</b>	<b>2967</b>	<b>9480</b>

Source: *Internalization of European SME's, Final report, European Commission, 2010, p.17*

import, FDI or long-term production cooperation), as opposed to small and micro enterprises where this percentage is 58% or 43%, respectively.

To compare the extent of internationalization of the SMEs among member states and six non-EU countries are used the data shown in Table 2.

Table 2

<b>PERCENTAGE OF SMES WITH INTERNATIONAL BUSINESS ACTIVITIES IN 2006-2008, BY COUNTRY GROUP</b>			
<b>Mode of internationalization</b>	<b>EU</b>	<b>Non-EU</b>	<b>Total</b>
<b>Percentage of all SMEs</b>			
SME with direct exports	25%	28%	<b>26%</b>
SME with direct imports	29%	33%	<b>29%</b>
SME invested abroad	2%	3%	<b>2%</b>
SME with technological cooperation with enterprises abroad	7%	9%	<b>7%</b>
SME has been a subcontractor to a foreign main contractor	7%	13%	<b>8%</b>
SME had foreign subcontractors	7%	7%	<b>7%</b>
SMEs with at least one of these 6 international activities	44%	49%	<b>44%</b>
<b>Total N, unweighted</b>	<b>8332</b>	<b>1148</b>	<b>9480</b>

Source: *Internalization of European SME's, Final report, European Commission, 2010, p.20.*

Based on the information provided is perceived that in the member states of EU, 44% of SMEs are internationalized based on at least one activity, while the percentage among non-EU countries is higher and is 49%.

Also an important aspect in the research presents sectorial analysis in order to see the extent of internationalization of the SMEs by sector. Based on this analysis recognizes that:

- imports highest percentage of internationalization in of the wholesale,
- the export is internationalization in the domain of wholesale and manufacturing,

- in FDI and technical cooperation, internationalization is the highest in business services and
- for SME has been a subcontractor to a foreign main contractor and SME had foreign subcontractors, internationalization is the highest in transport and communications.<sup>5)</sup>

The results of this survey are in favor of the previously given conclusions the advantage and the need for internationalization of business. The SMEs that are much more internationalized realize higher income from sales, higher employment rates, and greater transfer of technology and introduction of products and processes innovated in relation to SMEs who are not internationalized.

## **CONCLUSION**

In the contemporary term the internationalization presents the need and necessary, for all types of companies in the modern era of economy. Companies, as well as the countries may gain numerous benefits of this process, but at the same time, they can face with many barriers that difficult and slow down this process.

Overall, the internationalization is very expensive, requires time, knowledge and skills that is particularly constraining for small and medium enterprises, because these companies have very limited funds. Therefore is very important, in the process of making decision, managers have to make the right decisions about timing and how to enter to foreign markets. There is no universal model that can be applied to each individual case. This is especially emphasized in modern conditions, due to large uncertainty and unpredictability of future trends in the development of economy and market. In respect to future business operations for the internationalization of the operations of businesses requires finding an appropriate combination of existing models for the input.

Key motives of the enterprise where, why and how to expand their business in foreign markets lies in adequate selection and identification of opportunities and capabilities of the manager or entrepreneur and their propensity to risk. Experience of entrepreneurs or managers and their network of contacts play a key role in the development of relevant knowledge of the internationalization of the business. Managers simply must understand the motives, the importance and need to be involved in this challenging and sophisticated process. To be successful in the global economy means to possess the ability to dealing with constant change; to identification key business factors; to make decisions whose outcomes are unpredictable; to have a vision and to

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<sup>5)</sup> For more information see Final report: Internalization of European SME's, European Commission, 2010, p.19.

transmit it to other employees; to choose the optimal strategy and to motivate employees to implement the goals.

On the other hand, when we consider the role and importance of the SME sector for the development of a national economy, the government support to SMEs is needed in order to encourage them in making a decision of the internationalization of business. Such support includes several activities such as: providing opportunities to acquire knowledge for the management for the companies that haven't international experience; to assist in identifying compatible foreign partners for joint ventures and/or cooperation; stimulate exports through strong institutional support (Strategy for export, formation of investment promotion agencies, providing funds under the favorable terms) and etc.<sup>6)</sup>

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