

**“A THEORETICAL APPROACH TO THE PROCESS OF INTERNATIONALIZATION OF SME’s”**

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ABSTRACT

In recent times, small and medium-sized enterprises (SMEs) have become a familiar form of business organization. They have a significant contribution on economic development creating significant number of jobs around the world. Elo (2005) mentions; SMEs are the largest source of employment which plays a considerable role at regional and international level enhancing innovativeness. According to the European commission the ratio of SMEs to the number of inhabitants are 58 SMEs per 1000 inhabitants (European commission 2011). Total workforce generated by SMEs was 33% on private sector in 2005 and it has increased to 59% (European Commission 2011). SMEs were struggling with economic and financial crises in 2008. Despite this fact, recent research has shown that most of the SMEs are in recovering phase. Nevertheless, SMEs have been contributing significant amount of growth in the economy. Therefore, the importance of SMEs cannot be neglected. Furthermore, SMEs are generating approximately 90 million jobs all around Europe with contribution on innovation and economic growth. (EU commission 2011).

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1. INTRODUCTION

Internationalization theories has been developed last a few decades intensively with different viewpoints such as management, international management, small business management, marketing, organizational theory. Internationalization activities with reasons and factors have been studied by both large in addition to small businesses (Ruzzieret. All. 2006). In market economies cross border interaction changed name and the term of globalization start to be used replaced by imperialism in 1920's. Nevertheless, internationalization process becomes more crucial phenomena after 1970 with the globalization emerge. Literature of internationalization is immense, many research focus on field that firms operations in foreign market (Welch & Loustarinen, 1993., Calof& Beamish, 1995., Johanson& Mattson, 1993) relationship process (Johanson&Vahlne 1990., Lehtinen&Penttinen 1999) and development of recourses (Ahokongas, 1998).

2. DEFINITION OF INTERNATIONALIZATION

It is hard to find a single definition of internationalization that suits in all aspects and environment. Scholars have defined internationalization in diverse way. In this article we will concerned with outward internalization. In this section of our work, we will try to integrate different definitions about internationalization of SMEs developed by several scholars. Internationalization can be defined as the firm's outward movement (Welch & Luostarinen, 1993), process of increasing involvement in global operations (Calof& Beamish 1995). Johanson& Mattson, (1993) also supports internationalization as the process, where firm formulates its strategy and structure to international environment utilizing the resources in order to achieve the firm's objectives (Johanson&Vahlne 1990). According to Ahokangas 1998, internationalization is process where firms mobilize the accumulated resources in international activities. Internationalization can be viewed as the integrated network of business relationships in foreign country that are continuously constructed, maintained and dissolved (Johanson&Vahlne 1990; Lehtinen&Penttinen 1999).

For this article we will be using definition of internationalization by Lehtinen and Penttinen, 1999, and Beamish 1990 as an appropriate definition. "Internationalization concerns the relationships between the firm and its international environment, derives its origin from the development and utilization process of the personnel's cognitive and attitudinal readiness and is concretely manifested in the development and utilization process of different international activities, primarily inward, outward and cooperative operations" (Lehtinen&Penttinen, 1999).

The process by which firms both increase their awareness of the direct and indirect influences of international transactions on their future, and establish and conduct transactions with other countries" (Beamish 1990 in Elo 2005). Internationalization can be defined as:

- The practice where firms intend to set up position in new network,
- Evolutionary process where firms change its role within the network (Elo,2005)

3. INTERNATIONALIZATION THEORIES REVIEW

Researchers have identified several types of internationalization process for SMEs (Freeman 2002). If we review the various articles than we can find different school of thoughts presented by several researcher including traditional as well as recent models such as eclectic model, foreign direct investment (FDI), stage model, born global approach and the network approach (Battaglia, et. al., 2006)

Eclectic model develop by Dunning 1988 cited in Ruzzier 2006, presents the views that to start the internationalization process firm needs to satisfy three basic conditions; ownership advantage, internalization advantage and location advantage. In other words, for investment in foreign market firm need to have competitive and internationalization advantages along with the superior location advantages of host country as compared to the country of origin (Battaglia, et. al., 2006). Almost similar to eclectic model, Foreign Direct Investment (FDI) theory explains firm's internationalization activities like choice of market location, strategic entry modes and sequence are determined by evaluations of optimal economic transaction cost (Buckley & Casson, 1993).

Another school of thoughts (stage model) include two different model of internationalization- Uppsala internationalization model and innovation-related models (I-models). Both the models explain the internationalization in stages among which Uppsala model became most popular. Uppsala model described internationalization as a sequential process of learning where firm passes through increased commitment to foreign market. In other words internationalization in this model is viewed as process of increasing firm's international involvement due to different types of learning (Ruzzier 2006; Johanson&Vahlne 1977, and Battaglia, et. al. 2006). I-modelviewed learning process in various stages as an innovation of new ideas (Battaglia, et. al., 2006 and Chetty& Hamilton 1996). Ruzzier (2006), mentioned I-model focuses on the learning sequence in adopting an innovation, and firm treats internationalization as sequential innovation.

In recent days new approach to firm's internationalization has been developed. Network approach and born global approach of internationalization can be consider in this regards. Network approach explains firms get internationalized by establishing relationship with partners in foreign networks. It emphasize on relationship between companies, involved production, distribution and use of goods and services within industry (Coviello& Munro 1997 and Johanson&Matsson 1993). Born global is an emerging concept in internationalization process especially used by high tech and fast changing



technological firms. This view stand on the point that firms do not internationalized incrementally rather enter international markets right from its inception (Oviatt& Mc Dougall 1994; Harveston, 2000 and Knight &Cavusgil 1996).

Reviewing the above mentioned models, in this article I choose to consider the Uppsala model of internationalization. In my opinion Uppsala model is more extensive and realistic which covers networking aspects of internationalization and explains the internationalization of firms in incremental sequential process of learning with increase commitment. Long-term relationship is becoming effective mechanism for SMEs to increase their knowledge (Park et. al., 2010).

Table1:Below Presents Summary ofthe Theories from Three Different Schools of Thoughts.

	Theories	Authors	Year
Entry Model	Eclectic Model	Dunning 1988 Cited in Ruzzier, M., Hisrich. R. D., and Antoncic. B,	2006
	Foreign Direct Investment (FDI)	Battaglia. L, Corsaro. D, and Tzannis. A.	2006
Stage Models	Uppsala Internationalization Model	Johanson, J. &Vahlne, J-E.	1977 2009
	Innovation-Related Internationalization Model (I-Model)	Bilkey, WJ., and G. Tesar	1977
		Reid, S.D.	1981
		Czinkota, M.R.	1982
	Gankema, H.G.J., Snuif, H.R and Zwart, P.S	2000	
Network Model	Network Approach	Coviello, N. and Munro, H. J.	1997
		Elo, M.	2005

3.1. Uppsala Internationalization Model

Johanson and Vahlne developed a model called Uppsala Model which introduced internationalization process of the firms in progressive stage. Uppsala model was the pioneer study that explained the process of firms' going global or entering foreign market and grabs the attention of most researchers in the field. This model explains the internationalization of firms, relating the progress of acquired learning and gradual commitment which assist in the development of firms into foreign market. Especially, focusing to benefit of knowledge that firm gains to get into international market to gain incremental profit. Knowledge canbe two different types, objective and acquired knowledge. I will concerns with the acquired knowledge, and do not explain the knowledge from objective perspectives. Uppsala model explain the acquired knowledge; which could be alliance with partner in local market (Lu & Beamish, 2001) or in other words involving firms into foreign market (Johanson&Vahlne, 1977). How firms gain the knowledge and how this knowledge affects their investment behavior is core issue mentioned in the model.

Another important conjecture is due to market uncertainty an investment decisions should be incremental. Incremental decisions could be perceived as managerial skills and ability achieved through learning by doing. Market knowledge and market risk has inverse ratio, when knowledge get higher the risk is low that constitute higher level of foreign investment. Johanson and Vahlne also mention another important assumption that knowledge cannot be transmitted in all the cases. Every individual has their own experience that contributes in firm's internationalization process (Forsgren, 2002).In the lightening of this information Uppsala model has four core concepts; these are market knowledge, market commitment, commitment decisions and current activities. These activities are basic mechanism of internationalization. The Uppsala model represent two aspects first one is state aspect which includes market knowledge and market commitment, second is change aspect and those are commitment decision and current activities. "Market knowledge and market commitment are, in turn, affected by current activities and commitment decisions" (Johanson&Vahlne, 1977. Figure 1 (outer).

Commitment decisions are based on two type of knowledge therefore aspects of market knowledge are significant. "One type of knowledge is objective knowledge, can be taught; the other type of knowledge is experience or experiential knowledge, can only be learned through personal experience"(Johanson&Vahlne, 1977). Experimental knowledge is crucial to provide a framework for observing, expressing opportunities and leading firms to generate business

opportunities, which assist firms to proceed in the internationalization process (Johanson&Vahlne, 1993). Market knowledge creates strong commitment to the market that makes more significant to have market knowledge which is also valuable resource (Johanson&Vahlne, 1977).

Market commitment involves two factors one is amount of resources committed and the other is degree of commitment. Amount of committed resource correspond fairly well with the level of investment, degree of commitment correspond to how the firms engage into international operations. Commitment role is creating interdependence, that clarified reason why firms go to international market and why firms has participate in operations in those markets (Johanson&Vahlne, 1997).

First change aspect is commitment decision to commit resources into foreign operations. That is also presumed decision rely on experience. Beside experience effects how a company observe problems, opportunities and uncertainty. Commitment decisions are consequences of experimental knowledge which are the origin of the decision results.

Second aspect is current activities. Consistency role in business activities is crucial, without that there is a gap between current activities and consequences. Management and market activities need to be repeated to attain the consequences. Furthermore current activities which are main source of experience can be classified like firms and market experience. These both experiences are required for firm's high performance. This is possible by hiring personnel with experience or gets advice from a person who has experience. A person who is working in the foreign market for company should be able to observe work from inside as well as from market. Without market knowledge and experience this observation cannot be done. Finally, gaining experience is a long learning process. Consequently internationalization is a long process and gain is slow (Johanson&Vahlne, 1977).

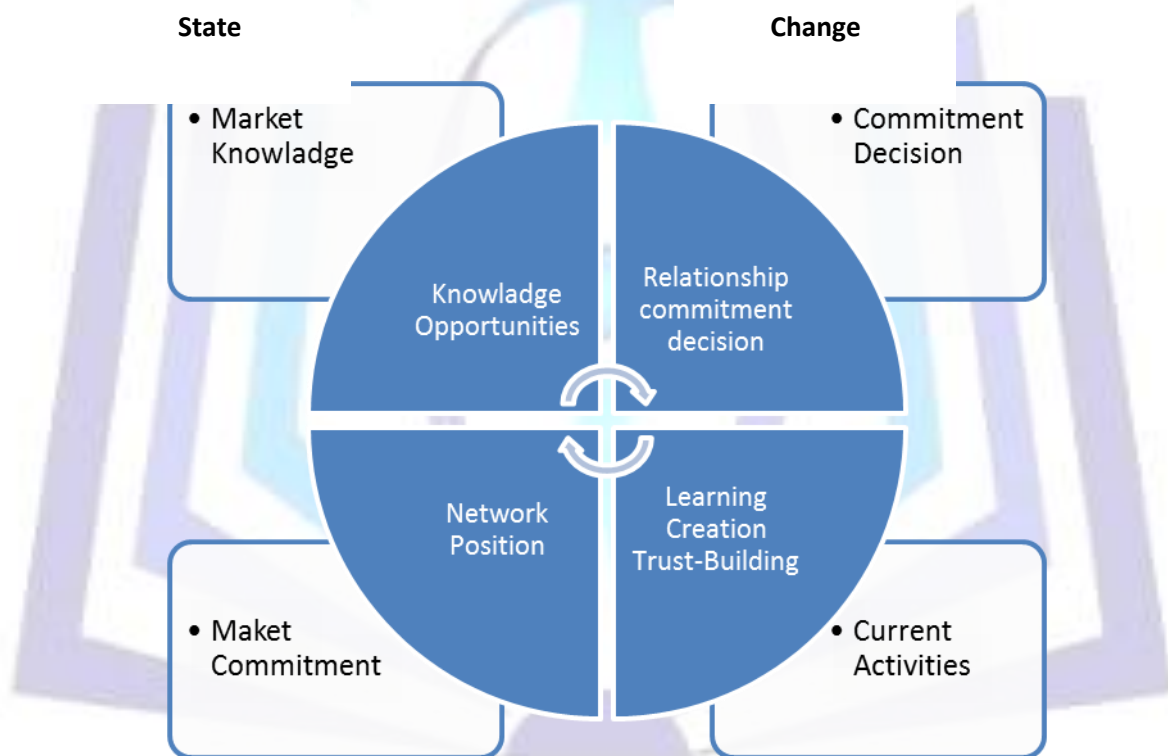


Figure -1-Uppsala internationalization model developed based on Johanson&Vahlne, 1977 &2009

The Uppsala Internationalization model revised the view of changes on theoretical advantages and business practice that have been made since 1977. Business environment look different from the past, new instrument has been included such as web of relationship and the network with suppliers and customers (Johanson and Vahlne, 2009). The state aspects are knowledge, opportunities and network position. Change aspects are relationship commitment decision, learning creation and trust building (see figure 1).

Especially, including networks approach has shown the significance of relationship in the internationalization process. Companies' environment (relations, connections) are made up of networks and applied through learning, building trust and developing commitment to identify and explore the opportunities. In addition new article integrate internationalization with entrepreneurship. In the following stages Johanson and Vahlne discuss these stages of knowledge and learning, trust and commitment building, and opportunity development.

3.1.1. Knowledge and Learning

Uppsala Model is based on developing knowledge within the operations that is very significant to internationalizations of the firms. Knowledge is gained through experience and practice by firm's activities. Firms need time to discover new institutional market knowledge and business knowledge which is caused to specific extra cost. Lack of Institutional market knowledge like language barriers, laws, and rules because of being foreign and due to psychical distance hinders the process of internationalization of firms. Business market knowledge is the relationship between current firms with other firms operating in same environment which is doing business or trying to do business. This knowledge is learning and gained by experimental learning that is basic mechanism of internationalization process (Johanson & Vahlne 2009).

3.1.2. Trust and Commitment Building

The Uppsala Model (1977) was criticized for not including effective and emotional dimensions. In revised model they clearly include these dimensions. Cognitive element need to be included because much thing has changed via social capital, trust and commitment. One of significant factor and effective dimension which has important role on understanding relationship is trust and commitment among firm within the networks. Trust play crucial role for relationship development and business network. Johanson and Vahlne mention that trust could replace knowledge as well. For instance, if somebody lacks knowledge building trust helps firms to have a middleman run the business activities in other countries. Johanson and Vahlne, Madhok, Boersma, Buckley, and Ghauri all agree that "trust building is a costly and time-consuming process". Subsequently, commitment is developed through trust building which is highly applied to relationship in general (Johanson & Vahlne 2009).

3.1.3. Opportunity Development

In the frame of Network Perspective on markets firstly, knowledge should be built between partners who have interactions than trust need to be developed to commit for building better relationship. Later, opportunity development could be based on this process. During this interaction some knowledge could be developed and this may help partners to recognize opportunities that others do not. It is a substance of correlated process of knowledge development- commitment to an opportunity. This process may be unilateral (one firm) bilateral (two firms) or multilateral (several firms) interacting and increasing their knowledge-commitment to idea or opportunity. Additionally, opportunities investigation usually differentiates two phases, recognition and exploitation. Opportunity development is correlated phases progressively increasing recognition (learning) and exploitation (commitment) of an idea or opportunity (Johanson & Vahlne 2009).

4. SMEs INTERNATIONALIZATION PROCESS

Below illustrated model in figure 2 presents the review of theories in incremental internationalization. As explained in Uppsala model, firms increase their international involvement in small incremental steps. The model illustrated below present (summarize) the process SMEs' follow to expand their business in international market as presented by several authors.



Figure-2-Pattern of internationalization by SMEs developed based on U-model and Elo (2005).

In the first stage, SMEs engage in domestic operation without regular export activities (Johanson & Wiedersheim-Paul, 1975 in Elo, 2005). In this early international stage (Johanson & Mattsson 1998) firm engage in developing foreign knowledge



with intentions to get internationalize (Coviello and Munro, 1997). Fletcher (2001) called it as inward and/or outward activities of firm.

In the second stage, SMEs start export through agents (JohansonWiedersheim-Paul, 1975 cited in Elo, 2005) and engage in inward internationalization activities (Welch, 1990; Welch &Loustarinen 1993). In this lonely international stage (Johanson&Mattsson, 1998) firm identifies internal and external forces and engage in foreign market evaluation (Coviello& Munro, 1997). Fletcher (2001) called it as development of linkage between inward and outward activities.

When SMEs are at third stage of internationalization, they establish sales subsidiary overseas (JohansonWiedersheim-Paul, 1975 cited in Elo, 2005). In this late starter phase (Johanson&Mattsson, 1998) firm establish linkage with the foreign network and shows committed involvement in many markets. Fletcher (2001) called it as development of linked international activities.

In the final stage, SMEs starts overseas production (JohansonWiedersheim-Paul, 1975 cited in Elo, 2005) and engage in cooperative internationalization (Welch &Loustarinen 1993). Firm realized their entry in the foreign market (Blankenburg Holm 1995 cited in Elo, 2005).

5. CONCLUSION

Most of the theories explained above presents that in firm's internationalization, lack of knowledge is the common problem. Especially firm lacks experiential knowledge and the uncertainty associated with the judgment to internationalize (Elo, 2005). Learning, knowledge, close relationships, variation in target markets, experience and the use of entrepreneurial and business networks are known as endogenous issues affecting SME's internationalization whereas exogenous issues varies (Elo, 2005). Coviello and Munro (1997), mention that SMEs follow a pattern while carrying their activities to foreign market and they often relay on network relationship for the market selection and mode of entry. Holistic approach explains that level of growth obtained by firm through internationalization is main reason for SMEs to get internationalization. Based on above constructed pattern I try to explain internationalization process of SMEs regarding learning, experiential knowledge, commitment and growth.

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