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How to Internationalize your Business

Guidebook for German Companies

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Tutkimuksen taustalla on se, että pienet - ja keskisuuret yritykset eivät ole yhtä kansainvälistyneitä kuin suuremmat yritykset; näin ollen ne tarvitsevat enemmän tukea aloittaakseen toiminnan ulkomailla. Täytyy ottaa huomioon, että tutkimuksen havainnollistamiseksi yritykset täytyi jakaa mikro -, pieniin, keskisuuriin - ja suuriin yrityksiin. Tutkimuksen tavoite oli hankkia pienille - ja keskisuurille yrityksille hyödyllistä tietoa tukemaan heidän kansainvälistymisprosessiaan. Tätä tavoitetta silmällä pitäen tehtiin kehys kansainvälistymiselle joka on pääpiirteissään toimiva kaikille pk-yrityksille. Kehys sisältää näkökulmia liittyen kansainvälistymiseen ja siihen liittyviin prosesseihin. Monilla näistä näkökulmista on erilaisia vaikutuksia yrityksen koosta riippuen. Kehys sopii erityisesti mikro- ja pienikokoisille yrityksille, koska kvantitatiivisen tutkimuksen aikana kävi selväksi, että pk-yritykset eivät ole yhtenäinen joukko. Kokoon perustuva lajittelu näytti selvän yhteneväisyyden yrityksen koon ja kansainvälistymisasteen välillä. Tämän johdosta pääpaino siirtyi mikro - ja pieniin yrityksiin. Kehitetty kansainvälistymiskehys sisältää muun muassa syyt kansainvälistymiselle, yleisimmin käytetyt kilpailustrategiat sekä markkina-analysointia koskevan osuuden. Tämän lisäksi eri markkinoillepääsytapojen etuja ja haittoja käsiteltiin yksityiskohtaisesti. Seuraava kansainvälistymisprosessin merkittävä osa on rahoittaminen, joten eri rahoitustavat käytiin läpi. Viimeisenä, muttei vähäisimpänä, selvitettiin kansainvälistymisen edellyttämät muutokset yhtiörakenteessa. Empiirinen osio tarjosi yksityiskohtaiset tiedot nojaten niin kvantitatiiviseen kuin kvalitatiiviseen tutkimusmenetelmään. Menetelmien yhdistetty käyttö mahdollisti kunnollisen kuvan saamisen kansainvälistymisprosessista. Kävi myös selväksi, että mikro - ja pienet yritykset kohtaavat haasteita kansainvälistymisessä, kun taas suuremmilla yrityksillä ei juurikaan ole ongelmia asian kanssa. Tämän lisäksi esitetään tutkimuksen merkittävimmät avainhavainnot. Kvantitatiivisen tutkimuksen analysoinnin aikana löydettiin johdonmukaisuus joka poiki uuden teorian. Uudella teorialla saattaa olla mahdollisuus tulevaisuuden lisätutkimukseen yrityksen kokoon -, kansainvälistymisen haasteisiin - sekä kansainvälistymisasteeseen liittyviin syy-seuraus-yhteyksiin.

Avainsanat: kansainvälistyminen, kansainvälistyminen, pk, kansainvälistyminen tekijät, kansainvälistyminen ongelmat, esteiden.

ABSTRACT

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The background of the study is that small and medium sized enterprises (SMEs) are not as internationalized as larger companies; therefore they need more support to establish foreign operations. It has to be seen that during the research a need for stronger differentiation between micro, small, medium and large companies was discovered. The aim of this research was to provide useful information to SMEs to support their internationalization process. Based on this goal an internationalization framework was established which is generally applicable to all SMEs. It includes various aspects concerning the internationalization and the related process. Many aspects have different influences to different companies. Especially micro and small sized enterprises are the target group for this framework because during quantitative research it became clear that SMEs are not a uniform group of companies. The differentiation based on the size showed a clear relation between size and the degree of internationalization, taking this into consideration the main focus shifted to micro and small sized businesses. The internationalization framework which was established included several factors like the reasons for internationalization, the competitive strategies which are generally used, as well as a section concerning the market analysis. Additional to these aspects the entry modes with the related advantages and disadvantages were discussed in detail. Another major part of the internationalization process is its financing. Therefore, different methods of financing were described. Last but not least changes in the corporate structure based on the internationalization were lined out.

The empirical study provided in-depth knowledge based on a quantitative as well as a qualitative research; both combined enabled the research to get a full picture of the internationalization process. It also became clear that just micro and small sized businesses really face challenges related to the internationalization while medium and large companies do not face problems related to their size anymore. Additional to this, different key aspects based on the results of the research were presented. During the analysis of the quantitative research a pattern was discovered which lead to new theory in the end of the research.

Keywords: Internationalization, internationalization process, SMEs, internationalization factors, internationalization problems, overcome obstacles.

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1 INTRODUCTION

This thesis will be about the internationalization of German small and medium sized enterprises. Germany is highly integrated into the world economy; during the last decade the German economy relied heavily on foreign markets to generate growth. The poor performance of the domestic market in the recent years underlines the necessity for German companies to push their international exposure. (Eurostat 2012)

It is important to acknowledge that major companies in Germany are already highly internationalized which has had a strong impact on sales and profit growth. The only companies which are still lacking internationalization are small and medium sized enterprises (SMEs), even as those companies generate 1,91 billion Euro revenues just 170 billion Euro of them are generated by foreign sales. Just 25% of the German SMEs are already internationalized while 75% are still domestic oriented, meaning that there is a big potential for those companies to expand abroad. The key issues discussed in this thesis are therefore based on small and medium enterprises; this guidebook should lead SMEs to a successful internationalization of their businesses. (Geyer & Uriep 2011)

1.1 Key aspects of this study

Internationalization is not just a word; a whole spectrum of different aspects lay behind it. The first step is to analyze the potential markets into which those companies are expanding, considering the attractiveness of the market, talking about the size of the market and the growth potential but also about the political situation in those markets. When the future market is determined the next issue is the implementation: How should the market be entered? There are several different ways of entering markets and different theories about it. By considering the pros and cons of those we have to define which way is the most suitable for different kind of businesses.

Entering new markets is not just about selling products in those markets, most of the time the company has to adapt its structure to internationalization. Therefore changing the organizational structure can be the key, we have to change the company in regards to be successful beyond the domestic market. Companies have to adapt their structure to the degree of internationalization; in the real life it means creating new departments and organizing the supply chain on an international level.

The thesis is based on small and medium sized companies, because they are facing different problems than larger full-fledged multinational enterprises. MNEs have most likely already international experience, while small companies are lacking the knowledge about how to internationalize their business. Especially the financial issues, the different ways of acquiring capital have advantages and disadvantages which will be mentioned. But not just those factors are influencing the success of the internationalization process; it also depends on the entry mode which is chosen, especially talking hereby about the risk management in terms of entry strategies. Small and medium sized companies in general are more flexible, the hierarchies not as strong as in bigger companies and therefore they can push to international markets very fast to satisfy the demand abroad.

One of the most crucial things to consider is the difference in national cultures, when German SMEs are going abroad most likely they do not know how to deal with the cultural difference and therefore it is very important for them to know how to get information about the new markets from a cultural point of view, how to negotiated with people in the new market etc. The SMEs will also deal with corruption and to which extend it might affect their business in the target market.

When we consider all those issues related to internationalization we see the need for getting a deeper knowledge about those aspects, it is important to understand the differences between them and how they are interrelated, therefore this study is made. This study tries to give a deeper understanding of the internationalization process and guide SMEs the way to international markets.

1.2 Research problem and limitations

The aim of this thesis is to create a framework which is guiding German small and medium sized enterprises through the internationalization process. The key objective for this research is to show the different factors which are influencing the internationalization process on a micro-economic level.

The thesis is aiming to clarify the process, the single steps which are built on each other in the internationalization process and the necessity to go through the single steps. The thesis is following a quite broad approach, not just focusing at a single aspect but on all stages of the internationalization process, this is the reason why the research problem can be divided into sub problems which are handled during the thesis following a chronological order to address questions which might arise otherwise.

The research itself is focusing on German small and medium sized enterprises, therefore the thesis is not handling domestic problems related to regulations and legal issues which might arise out of the internationalization process in the German market, it is important to draw a clear line between the internationalization process and related issues which are described and the problems which might result from the domestic market, like political and regional differences inside Germany.

1.3 Structure of the research

The research consists of a theoretical as well as an empirical study. The theoretical study which is named “Internationalization Process” offers a theoretical framework for the thesis based on the literature review while the empirical section contains a qualitative and a quantitative research.

The first Chapter handles the introduction to the research, what should be researched. Also the structure of the research is explained. Additionally to this the research limitations are described, considering the broad field of

internationalization it is necessary to limit the research breadth. It deals with definitions, due to the fact that even the term small and medium sized enterprises (SMEs) is widely used, the understanding varies and has to be clarified. Additional to this the terminology of internationalization is described briefly to give the basis for the further chapters. Additionally I have to be seen that SMEs are different from bigger organizations; therefore there is a special need to address those problems before actually entering the main internationalization process. While dealing with the internationalization of SMEs the special needs for SMEs have to be known.

The second Chapter handles the main objective of this research; it deals with the internationalization process. When going through the several stages of the process itself, subcategories will be opened to handle the complexity and make the topic better understandable. This chapter also handles the changes of the corporate structures, most of the SMEs are based on organizational structures which are generating disadvantages during the internationalization; therefore other organizational structures are explained given an objective evaluation in terms of advantages and disadvantages.

The third Chapter is about the quantitative as well as the qualitative research. The quantitative research is based on a questionnaire which were mailed to German SME 's and analyzed by using charts and graphs. One of the main aspects of this chapter is the implementation of the quantitative research as well the population design and the problems which have to be faced. This is followed by an in-depth analysis of the questionnaire results. The qualitative research was conducted via interviews among senior level managers of German SME's; the qualitative research gives further information about the obstacles which have to be faced during the internationalization process. The interviews are recorded and analyzed by coding the content.

The fourth Chapter closes the research; it is about the overall findings and the critical aspects of the internationalization process. Additional to this a new theory

is developed which can be used to determine the under exploitation of the internationalization potential. Another issue is the final proof that the research is reliable and valid.

1.4 Definitions

Definitions are needed to get a uniform understanding what certain terms mean, for this research two terms will be explained in detail because the research is based on them. If the meaning would not be clarified the research would be not valid due to possible misunderstandings of this terms.

1.4.1 Small and medium sized enterprises (SMEs)

The definitions for small and medium sized enterprises vary significantly; several different aspects can be used to measure if a company can be regarded as a SME. Some researchers evaluate companies based on their revenue and profit, which is problematic because both are influenced by inflation and the exchange rate if they are already operating abroad. Another measurement is the number of employees, via this definition SMEs are companies which have up to 249 employees, between 0 and 249 employees the company spectrum can be further differentiated to micro, small and medium companies. (Morrison 2011, 14)

But as mentioned earlier the definition is heavily dependent on the country, while talking about SMEs from the United States the limitation is 500 employees, on this discrepancy we can see that there are no clear limitations. (OECD 2005)

In this research the European Commission's definition will be applied based on the number of employees and the revenue. (European Commission 2009, 3)

Table 1. SME definition of the European Union

SME Definition				
Enterprise category	Ceilings			
	Staff Headcount (number of persons expressed in annual work units)	Turnover	Or	Balance sheet total
Medium-sized	< 250	≤ € 50 million		≤ € 43 million
Small	< 50	≤ € 10 million		≤ € 10 million
Micro	< 10	≤ € 2 million		≤ € 2 million

As shown in Table 1 micro sized enterprises are defined as companies with less than 10 employees, the second criterion is that they have less than two million euro revenue. Small sized enterprises have between 10 and 49 employees and their revenue is not allowed to exceed 10 million euro. Last but not least medium sized companies can have 50 to 249 employees while their revenue should be more than 10 million euro but less than 50 million euro.

1.4.2 Internationalization

Internationalization is often used when talking about the changes in the modern time, it is not just limited to the economics, and it also affects the politics and the social environment we are living in. Over the last few decades the economy has changed from a domestic market oriented economy to a multiple market or global economy. The focus has changed away from the domestic markets, to a global view, not just the single domestic market is important for the company's success, but also the international economy, due to the globalization the domestic market has lost its importance to some extent and markets abroad are seen as more important in the future years. (Morrison 2011, 39-40, 48)

This shift was based on the rapidly decreasing cost of information and its distribution cost, especially since the internet emerged. We have to see that not just the cost decreased, also the time limitation disappeared, information is

accessible instantly at any place in the world as long as it is provided at some point of the world at any time. (Albaum & Duerr 2011, 42)

Over the last decades, especially since the 1990s the world is finally in the stage of full internationalization, not just from a financial point of view, but also from a product and supply chain point of view, production has been outsourced and to a big extent companies used the cost difference of developed countries and the big pool of cheap labor in the newly opened economies, like China, to reduce their production costs. (New source)

The economies are bound together like never before, the external trade has soured over the last decades and boosted the wealth level in all parts of the world. The internationalization is the biggest chance for companies to participate in the global upswing. The total number of potential customers in developing countries has increased dramatically, while the developed saturated markets experiences harsh price competition. The only way to be sustainable in the modern world is to participate in the internationalization and expand business to different countries, enlarging the customer pool and decrease the dependency on home markets. (De Búrca 2004, 554–562)

1.5 Problems related to the nature of SME's

Small and medium sized companies face problems related to their size, they cannot generate economies of scale due to their limited size, which is a big disadvantage compared to larger cooperations because it makes it harder to compete on a price level with bigger companies. (Luostarinen 1994, 9)

Another problem is that SMEs most likely do not have the necessary resources; they lack the knowledge and the capital for expansion. Therefore some SMEs have to operate differently than large companies. It is crucial to understand that to be small also offers advantages which are related to the fast decision making, as due to the structure of SMEs the decision making is most likely centralized, offering the chance to react quickly to new situations. Small companies are

generally based on a hierarchical structure; via a top-down order system a company can instantly focus all the resources on new tasks, therefore if possible opportunities are discovered SMEs can use the first mover advantage to establish themselves before the competitors become aware of the existing opportunities.

SMEs can also tackle market niches which are not attractive to larger companies because of their relatively small size. SMEs can completely focus on those niches, specialize themselves and dominate small markets; the high specialization in quite unattractive markets can enable SMEs to generate premium prices due to the lack of competition. Based on the positive experience of General Electrics under Jack Welch many big companies leave niche markets to focus on their main business field, and so offering a chance for SMEs to gain market share in those highly specialized markets. (Kotler & Armstrong, 2010, 228)

Due to the limited resources networks and partnerships can provide SMEs with external knowledge that can help them to penetrate new markets. This partnership model offers the possibility to reduce the risk of entry because preoccupied knowledge of the market from members of the network can be used. (Freeman, Edwards & Schroder 2006)

This knowledge enables companies to expand faster, avoid problems and improve their success rate. Partnerships also minimize the scale disadvantages, SMEs can eliminate competitors and benefit from a higher credibility and visibility in the new market. Depending on the depth of the partnership or cooperation SMEs can benefit from the economies of scale of the larger company as well. (Chetty & Stangl 2010, 1728 - 1729)

2 INTERNATIONALIZATION PROCESS

The internationalization process describes the single steps which have to be dealt with when a company wants to enter foreign markets. This complex process has different aspects which have to be considered, especially the interconnectivity of those steps is essential for the understanding to be successful. As the companies which are going international are facing different challenges, it is necessary to see the broader picture and not just limit the Internationalization process to the micro economic perspective.

2.1 Reasons for internationalization

Companies are internationalizing their business for various reasons; in general we can differentiate between companies which want to go international on their own first and others which have to go international because the environment forces them to do so. It is crucial get a clear picture of the multifaceted reasons which can lay behind the internationalization itself. (Czinkota 2004, 4) These reasons are of proactive and reactive nature, they will be discussed in more detail below.

Table 2. Proactive and reactive motives of internationalization from Czinkota

Proactive Motive	Reactive motives
➤ Profit and growth goals	➤ Unsolicited foreign orders
➤ Technology competence / unique product	➤ Competitive pressures
➤ Managerial urge	➤ Domestic market: small or saturated
➤ Foreign market opportunities / market information	➤ Extend sales of seasonal products
➤ Economies of scale	➤ Overproduction /excess capacity
➤ Tax benefits	➤ Proximity in international customer / psychological distance

2.1.1 Proactive reasons

Many small and medium sized enterprise searches for intensive growth, in terms of revenue and profit, due to their small size the companies are actively participating in acquiring new customers, whether they are domestic or abroad. New markets are a key for generating growth for those companies, especially considering the ability to generate higher profits in foreign markets due to varying price elasticity's, it might be possible that the same products can be sold at a higher price if the demand exceeds the supply. Especially fast growing countries, in terms of GDP growth and population growth, are very attractive for companies which try to bolster growth. (World Bank, 2012)

Even so companies should not overestimate their profit potential for the first few years when entering a market, because the start-up costs might be higher than expected due to difficulties arising out of multiple areas.

Another proactive reason for companies might be that they have a unique product, or a technological competence which can be exploited when internationalizing the business. The technological superiority of products can be seen as a key driver for internationalization, companies which are able to provide technological know-how to less developed countries are able to create a temporary monopoly in those markets because domestic competitors in those markets are not able to compete with the new entrants to those markets. This competitive advantage enables them to be out of competition and establish themselves. (Pett, Francis & Wolff 2004)

The management also plays an important role in internationalization, due to the preoccupied knowledge of the management. In small and medium sized enterprises the strategic decision making generally is done in the top level management, if those persons in the leading positions already have international experience it is beneficiary for the international expansion. Therefore the internationalization can be management driven, at the same time the risk related to

internationalization decreases sharply due to the deep knowledge about the markets. (Gruber-Mücke 2011, 100)

It also can be that due to the nature of small and medium sized enterprises economies of scale cannot be generated by just serving the domestic market. If it is not possible to generate economies of scale in the domestic market and those are seen as important to the success of companies, it might be a key driver to internationalize the business. Economies of scale generated by international expansion of the business is offering a big chance to generate a competitive advantage because the price per produced unit can be lowered significantly due to the benefits in the purchasing, production, service etc. (Hollensen 2011, 52 - 53)

Last but not least, considering the environment a company is operating in it also can be that the domestic or foreign governments are offering tax benefits for internationalization. Those tax benefits can have a big impact on the financial site, especially when there might be a tax relief, which is quite common in the Asian and Eastern European markets nowadays. Companies can use those tax benefits not just to lower the tax payments in the foreign markets, but also to reduce the amount of taxed profits in the domestic market. (IHK Reutlingen 2011)

2.1.2 Reactive reasons

When talking about reactive reasons it must be understood that companies are searching for international opportunities for themselves, but it can also happen that a company receives an unsolicited foreign order. Foreign companies have become aware of the company due to marketing reasons which were not directly aiming at acquiring international customers. Due to marketing activities on the domestic market like trade shows, or exhibitions it can be that foreign customers get interested in products from companies which are not operating internationally yet. The problematic issue related to unsolicited orders is that they can have two outcomes, it can happen that the company is gets the order from a foreign company and starts to internationalize the business because of the international demand. The other possibility is that the company does not get the order, this

might leave the impression that it is not possible to internationalize and due to this drawback fully focus on the domestic market. (Hollensen 2011, 54)

The competition inside of the domestic market can pressure companies to get involved in international business. Foreign competitors can enter the domestic market of the company and force it to act; it also can be that the domestic competition is getting too intensive, which is leading to a reduced order intake. If this situation occurs a possible answer is to escape from the competition by entering foreign markets where the competitive situation is not as harsh as in the home market. Another aspect which has to be considered when talking about the competition inside of the domestic market is the saturation of the market. If the domestic market is running bad due to economic reasons and the competition is increasing, it also can happen that an output gap is the reactive reason for the internationalization. If a domestically operating company is having under-utilized production capacity foreign markets can compensate the output gap. (Geyer & Uriep 2012, 9)

The third reason is the proximity of international customers, the absolute distance between the domestic market and the foreign market is heavily influencing the internationalization decision. The larger the distance the larger the uncertainties, but if the markets are geographically close to each other the uncertainty decreases. The effect is based on the increasing familiarity to the culture, habits, languages and business practices of foreign markets with decreasing distance to them. Therefore, it is not surprising that on the macroeconomic level when international trade flows are examined, the most intensive with neighboring countries. (Hollensen 2011, 55)

2.2 Competitive edge

To be successful in foreign markets it is important to have a competitive advantage. There are several theories which describe how a company can reach and maintain a competitive edge against their competitors. Especially when

dealing with internationalization of businesses, it is necessary to know where the company is able to perform better than others.

The generic strategy model developed by Michael Porter describes that companies can confer a major edge when focusing on different strategies. Those strategies are the segmentation strategy, differentiation strategy and the cost leadership strategy.

The cost leadership strategy, as the name says, is based on reaching a competitive advantage based on cost leadership generally focused on a broad market. There are several ways to achieve this position, first of all companies can make their processes more efficient, but it is also possible to establish the cost leadership position via outsourcing which reduces the labor cost. Another way is to use economies of scale to reduce the unit price in the production, or bundling the purchasing of raw materials. The cost leadership strategy aims at two different spots of the selling process because it can be applied in different ways, one is that the company is able to offer the products cheaper on the market than competitors, this would lead to an increase in market share, while another way is to put the prices on market level which means that due to the low cost structure the profit margins are quite high, those profits allow to invest further in automatizing the production or other processes to prepare for tougher competition on the price side in the future. (Peters & Zelewski 2009, 289)

The differentiation strategy stands contrary to the cost leadership strategy, while the cost leadership strategy tries to compete mainly in terms of price, the differentiation strategy focuses on developing products or services which are unique. Price is not a key criterion among those products because the uniqueness offers additional value to the customers for which they are willing to pay a premium. This strategy aims at generating low price elasticity for the products the company is selling; the uniqueness can be based on technological superiority, product design or the branding of those products. To generate a unique selling proposition for the differentiation strategy it is generally necessary to have access

to state of the art technology or an advanced research and development department as well as strong communication skills to brand the products.

The last strategy of Porter's model is the focus strategy or "niche market strategy". When applying this strategy the company tries to focus on a small segment while differentiating themselves from competitors or the company aims at generating a cost advantage. The positive side of this strategy is that the customers are normally having a high degree of loyalty which is binding customers to the company. Due to the fact that the market is quite small, compared to the both strategies described above, it is hard to generate high volumes, which might have a negative impact on the purchasing prices because the suppliers can be able to dictate the price due to the low volumes. On the other hand it is possible, due to the high loyalty, to pass through those additional costs to the customers. The advantage of this strategy is that due to the small size of the market and the high specialization it is possible to establish the company as technological leading in the narrow market. (Zehetner 2004, 39)

Porter also describe the fault of companies trying to focus on two strategies at the same time, than those strategies will not confer an edge because just when the company resources are focused on one of those three strategies it is able to benefit from them. Mixing strategies will lead to the problem of splitting the resources and the company will be "stuck in the middle" and fall behind competitors which are following one clear strategic outline. (Porter 2008, 81)

Especially for small and medium sized enterprises it is important to focus on a specific strategy, because the financial and human resources in SMEs are generally weak points.

2.3 Analyze your business

For small and medium sized enterprises it is even more important to know the current situation of the operational business than for larger companies, due to the fact that entering foreign markets is more risky. If the internationalization fails

there might be no second chance to do so, because of restraints resulting in management, as well as financial reasons. Therefore it is important that the first time works well. Depending on the strengths and weaknesses of the SMEs, the companies have to evaluate the current market position and the financial situation in which the company is. Additional to this the opportunities and threats arising out of internationalization have to be assessed to evaluate the company's chance for success. This procedure is well known under the name SWOT analysis. Managers need a clear picture about the strengths and weaknesses, as well as the opportunities and threats to analyze if the company is able to perform well on the foreign market which is to be entered. (Kotler, Keller, Brady, Goodman & Hansen 2009, 101)

When talking about the SWOT analysis it is important to compare the business to its competitors to know how to interpret data in order to come to the right conclusions. A company might have a profit margin which is regarded as high, but when we compare it to the average profit margin of the sector the business is performing poorly, absolute strengths can be a relative weakness. It is important to keep in mind that benchmarking offers the chance to see where companies currently are and where they want to be in the future.

Benchmarking is a crucial way to find out more about the company's performance, the strengths and weaknesses are internal factors of the business; they directly result out of the operations. Companies can analyze secondary data of the performance of competitors in several ways; one of them is to access the annual report or follow the news stream on them. Another way of gathering data for analyzing the strengths and weaknesses is to get in touch with suppliers and customers. External opinions have to be regarded as very important and this feedback can give vital information about the standing of the company. (Pilcher 2004, 1)

Strengths and weaknesses are based on the current internal situation on the company, while opportunities and threats deal with the examination of external situations which might affect the business in the future. When analyzing the

opportunities and threats in terms of internationalization the companies have to take a look at the target market where they want to expand to. If the company is lacking the expertise for doing so, external support should be taken into account.

After analyzing all four factors of the SWOT model, it should be possible to determine where to improve the business, how to enhance the current situation in order to be able to succeed in the foreign market. Especially realized threats and weaknesses are the key for a successful internationalization, because those have to be challenged at the beginning of the internationalization process and not during it.

2.4 Market scanning

The success of the internationalization is heavily dependent on the choice of the market which is to be entered. The previous steps of finding out where the company has a competitive edge, as well as the SWOT analysis are the foundation for figuring out which market might be worthy entering. The world is very diverse nowadays and the different markets offer different possibilities for different companies. Companies have to collect information concerning the target market and its potential, the cultural aspects which have to be considered as well as the legal conditions. Just when all those three categories are fitting to the company, its products and the company's competitive edge the internationalization can be successful.

2.4.1 Market analysis

The aim of the market analysis is to figure out how attractive a market is, it is necessary to evaluate the different markets to benchmark them to each other. The market which is seen as most suitable should be picked. Different factors are seen as important during this process.

2.4.1.1 Market size

The size of the market is important in determining how much products can be sold at the moment in this market. But companies should not just focus on the total output of the economy in terms of GDP, but figure out how many relevant products are already sold in the market or what the demographic situations looks like, also exports, imports and their growth rates are seen as important for determining the market size, not just for the current situation but also for the future. Gathering that information can be done in several ways, one of them is by picking government data, as well as analyzing the sales reports from competitors which are already in the market. Additional to this a market survey can be done to evaluate the customer demand, especially if the customer demand is not satisfied it can be a promising. (Russow & Okoroafo 1996, 51 - 52)

2.4.1.2 Market growth rate

When talking about the market growth rate the company has to predict how much a market will grow during a certain period. There are several ways of making forecasts, one of them is to make different scenarios which might occur under different circumstance based on the past growth rates. It is crucial to make different scenarios to see where the market will be in the future, at least a division in a negative, neutral and positive scenario should be done. Those scenarios should take different variables into account like demographics, sector trends, product life cycle and superordinate factors like business cycles. Especially for SMEs it is advisable to take more conservative estimations as a starting point because growth can be anticipated faster than dealing with overcapacity which might force a company out of the market to cut losses. (Russow & Okoroafo 1996, 50)

2.4.1.3 Market assessment

A company which wants to enter a certain market can also use more general macro-economic data to determine how promising it might be via a specific analysis of screening criteria. Combining demand and macro-environmental

factors the following model can give a clear picture of how well a market will suit to specific companies.

The data which has to be collected is generally based on three different categories, “product-specific market size and growth, factors of production cost and availability and the level of economic development”. (Russow & Okoroafo 1996, 51-52)

The product specific market size and growth determine how many products have been produced domestically; it also takes the imports and exports of those goods into account. When talking about the imports and exports it has to be seen that some countries are already very export driven, meaning that those countries have a strong surplus in the export balance of those specific goods, they import less than they export and this might be a negative indicator for the attractiveness, because this export surplus might be caused by a lack of domestic demand. It is also important not just to consider the absolute numbers; the relative numbers to each other might be telling even more about how the market is performing. (Esteves & Rua 2013, 22 - 23)

It is possible that the total domestic production is very high, but the external trade in comparison to the domestic production is relatively low. In this situation the relative data indicates that the exposure of the domestic companies in foreign trade is low, this might lead to the idea that the local companies are not competitive on an international level or, on the other hand, that the domestic market is performing extremely well so that those domestic companies are not forced to go international yet, therefore the market can be quite attractive for foreign companies to enter into.

There are several issues related to capital, labor and land which determine how attractive a market is. When dealing with capital, money supply has to be mentioned. This is about how much capital the central banks of those markets are providing to the economy, when the money supply is related to the availability of credit to the consumers and companies which are dependent on financing their

operations. Also, gross and net fixed capital formation is important to consider because those are accumulated by the past investments, investments go hand in hand with efficiency and productivity which can influence the competitiveness of companies in this specific market. If those capital formations compared to the GDP are high companies might face strong, already developed and state of the art competitors because the capital formations are based on investments. (Brunsdale, Lodwick, Rohr & Newquist 1991, 6-8 - 6-9)

Labor costs also determine the production costs, if the population is growing, stagnating or shrinking it has an impact on the labor costs, because the price of labor always depends on demand and supply. If the working force is shrinking it is pressuring the employers to increase wages and fight for labor while if the population is increasing there is enough supply to satisfy the demand with all the consequences for the employers and employees. Not just the population trends are influencing the labor costs, the employment situation is by far the biggest impact factor, and if the unemployment rate is high the domestic consumption generally is lower because of the lack of job security as well as low bargaining power of the employees. Depending on if a company wants to sell its products in those markets or just put the production there for reducing the labor costs the impact and evaluation of markets can vary dramatically. (Seputiene 2011, 278-279)

The overall level of economic development is shaping the market. Countries with a high GDP output might not be rich at all, to analyze the wealth of a society the GDP / GNP per capita are the most important variables which have to be considered. Additional to this the economic development based on the sectorial economy is important; depending on the economic development the relative strengths of the primary, secondary and tertiary sector are different. In less developed countries, generally having a low GDP per capita, the primary and secondary sector are dominant, while in high-income countries the tertiary sector is overwhelmingly important following by the secondary sector while the primary sector mostly is just between 1 to 3% of the GDP. (Albaum & Duerr 2011, 195)

2.4.1.4 Market profitability

The profitability of a market is important because it gives an idea on how much profit can be generated out of the sold products. There are different approaches to evaluate the market profitability, one of them is based on Porter's five forces model which includes the barriers to entry, supplier power, buyer power, threat of substitute products and rivalry among firm in the industry, all those factors together determine how profitable a market is. (Porter (E) 2008)

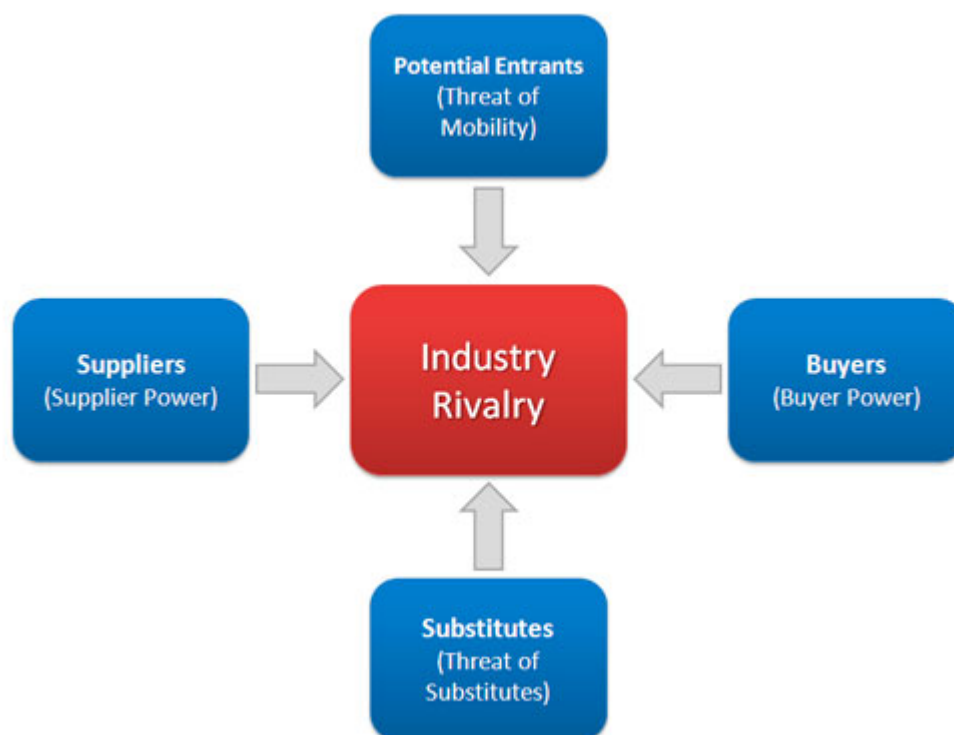


Figure 1. Porters 5 Forces

Several factors influence the threat of new entrants, first there are factors related to the attractiveness of the market itself, talking hereby about the absolute size, the growth rate of the market and its profitability. Those factors in general determine how attractive a market looks like for new entrants. But there also factors which work against new entrants, the so-called entry barriers. When talking about them we have to know that the market can be dominated by certain companies, especially in those markets where economies of scale play a crucial role the market entry might be challenging because without a certain size it can be

that the companies are not competitive. Also, capital requirements play a crucial role, because in capital intensive industries it might be simply not possible to enter without investing quite large amounts, e.g. in the railway industry or airplane industry. Also, customers can be seen as an entry barrier, if they are unwilling to change due to too high switching costs. Still, the government can set entry barriers by putting tariffs on imported goods or subsidize local companies that they can offer the products at a cheaper sales price.

Substitute products can be from similar items to the products which are provided in the same market, but also from a different market giving the same service. A commonly used example is the car industry; if gasoline as a complementary good to the cars is getting more expensive some people might change their habits and take the railway instead. So, we have to see that not just the relative price of the substitute products is important but also the complementary goods and their prices. It is also important to consider the quality of the substitute, is it giving the customer the same advantages or not. It also has to be kept in mind that the switching costs might be higher than the benefits of the substitute products. Taking the same example just in a different way, a person is commuting to his workplace by train, the train tickets get more expensive, but this person would still take the railway because the switching costs would include the price of the car which can be regarded as the switching cost to the buyer in this case. The overall market in this case would be transportation; substitute products offer the same service in a different way.

The buyer power is determined by the number of buyers compared to the number of sellers, it is always about how much influence the buyers can take into price negotiations. The bargaining power of the buyers increases if there are several sources where they can get the products from; it also depends on the volume, how many units a buyer can purchase at the same time. In some markets it might be that the purchasing party is able to dictate the market price. This situation can occur if there are several small sellers but just a few or a single buyer, demand and supply side than have a strongly misbalanced bargaining power. The

switching costs are also a factor which is determining the buyer's power, if the sellers would face higher costs in switching to different customers they most probably will stay with the purchasing party, even they are not as profitable as other parties in the market.

When it comes to supplier power, it is the counterpart to the buyer power, therefore also the product differentiation is important. If there are just a few suppliers which offer certain good the bargaining power of the suppliers is higher than vice versa. Another determinant of the supplier power is how diversified the customer side of the supplier is, if there are many companies which want to purchase the goods from the supplier the bargaining power is high. It also is important to see that suppliers can establish themselves as key providers of certain technologies, meaning they can specialize themselves which gives them a higher bargaining power due to the lack of alternatives in the market.

The rivalry inside of an existing market is also an important factor to consider when analyzing the profitability of a market for companies who want to enter. Depending on the number and size of the competitors it might that markets can be very profitable or not. If there are a few companies in the market which are dominating it, it might be that the prices for the consumers are higher than without this high concentration of market power, the profit margins would be high in this case. If markets are growing strong the competitive situation is weaker than in saturated markets, this is based on the fact that in growing markets companies do not have to fight to grow, even their market share stays constant and their absolute turnover will increase. The rivalry among existing companies also depends on the exist barriers. It might be that due to customers' service contracts or legal issues it is not possible to leave markets very quickly due to legal obligations arising out of customer service, guarantees and / or long lasting contracts.

It also has to be considered that even if a new company is going to enter a market it has to be considered that the entry on itself will have an impact on profitability because the entry of a new company is going to increase the industry rivalry, increase the buyer power because of a bigger choice, increase the supplier power

because suppliers can broaden their customer group and it gives a sign to other companies which might follow later on. The market entry of a company always has to be seen as negative for the market profitability, while the customers will benefit from it.

Another way of finding out how profitable the market will be for the business that is going to enter is to find out the average profit margins for companies in the target market which are in the same field of business. This can be done by analyzing the annual reports of competing companies which are already operating in the target market. (Porter (E) 2008)

2.4.2 Cultural aspects

There are not just hard facts which have to be considered when entering a market. The local culture of the target market is important for determining how difficult it might be to enter, because cultural aspects are shaping the society. (Mejri & Umemto 2009, 5- 6)

Culture is defined by Hofstede as "collective programming of the mind distinguishing the members of one group or category of people from others." (Hofstede & Hofstede 2005, 4).

Hofstede differentiates between six dimensions which determine the national culture of countries. Those aspects are relative; they always have to be seen in comparison with other cultures. Hofstede's model is useful for evaluating the differences of the domestic market's culture and the target market's culture.

2.4.2.1 Power distance

The power distance depends on the acceptance of unequal distributed power inside of the society. While countries with low power distance, like Scandinavian countries, try to establish common grounds with an equal distribution of power among the single individuals other countries like the United States of America accept inequality to a far larger extend. A society is shaped by inequality among its citizen, like respect towards old people, the acceptance of an elite or the

influence of wealthy individuals, the degree of accepting those issues influences power distance. Every country faces inequality to some extent, power and inequality go hand in hand and the knowledge how the power distance influences daily life is important to companies who want to enter foreign markets, as the behavior which might be appropriate in one country might not be in another. (Jandt 2009, 177 - 179)

2.4.2.2 Individualism vs. collectivism

Individualism is a measure of self-centeredness in a society, while collectivism on the other hand is the countermeasure of it. Collectivism in this context is not having a political meaning; it just describes the belonging to a group. Societies with a high level of individualism generally evaluate uniqueness as positive, on a relationship level Hofstede figured out that in individualistic societies the ties between individuals are loose while in collectivistic societies the relationships are far more extended. In individualistic cultures people's identity is a very personal issue, while in a collectivistic environment the identity is based on the social network like families or organizations. The working ethic also varies depended on this dimension of culture; in countries where individualism is regarded as high the personal success is promoted. On the other hand collectivistic oriented countries favor not stick out, success and failures are shared among groups. (Jandt 2009, 164 - 166)

2.4.2.3 Masculinity vs. femininity

Those factors are generally associated with gender attitudes in the national culture. Feminine dominated cultures are regarded as caring, equality is favored, gender roles are not in force anymore while masculine cultures are very competitive and status oriented. This dimension is not just influencing the personal lives, also the business life is heavily affected by it, in feminine cultures harmony and consensus is appreciated and most likely the society is offering equal opportunity for everyone, while in masculine coined societies it is more about competition, being superior, showing status and rank by achievements. (Hofstede & Hofstede 2005, 118 - 120)

2.4.2.4 Uncertainty avoidance index

This dimension is about how much a society is willing to take risks; a high uncertainty avoidance index shows that the society tries to avoid risks and ambiguity. It shows how well a society can deal with unexpected situations. On a personal level it means that people living in societies which try to avoid risks will most likely prefer stable working environments, be less entrepreneurial oriented and less innovative due the fact that every change in the current situation is bearing a risk of failure. Societies which are accepting risks are more open towards new ideas and new concepts, favoring a more liberal political environment and immigration. Societies which are risk averse try to focus on themselves, they are more isolated and less integrated in the world because the domestic market is well known and bears less risks, also the personal mobility can be limited inside of the country because the security feeling might just be given in a known environment. (Hofstede & Hofstede 2005, 164 - 166)

2.4.2.5 Long-term orientation vs. short-term orientation

This dimension is describing over which time horizon the future plans are done, in the long-term orientation a superior goal is set which is followed over years or even decades, this long-term planning style is common among East Asian societies, whereas western societies tend to favor short-term planning which is basically a result of the shareholder system which is common in big parts of Europe and Northern America. Extreme values for short-term orientation can be found in the United Kingdom and the United States, while the Chinese society is very long-term orientated. Long-term orientation is going hand in hand with high saving rates and a reduction in consume for preserving wealth for the next generations while short-term oriented societies favor instant consumption. (Jandt 2009, 180 & 182)

2.4.2.6 Indulgence vs. restraint

A society which prefers indulgency instead of restraint is focused on enjoying life, in general those societies tend to be very open towards progressive ideas how the

living standard can be increased on a social level. On the other hand we have societies which are following strict social norms, generally those nations are regarded as very conservative and the people living in those nations have to subordinate themselves to the rules of the society. In this category we can draw a clear line between western oriented societies and fundamental religious societies which are categorized under restraint. (Hofstede 2011)

Culture is a very complex topic, which cannot be fully understood by using those different aspects. By using those 6 dimensions companies can evaluate and compare the national cultures, but this model is just giving a framework how the national culture in certain countries is compared to the domestic culture where the company is currently operating in. (Sakarya, Eckman & Hyllegard 2007, 216-217)

Comparing cultures on paper might not be a good way to get a deeper insight of the national culture, it is advisable to get in touch with the culture of the target market by actually making field trips, to get used to the environment. Companies can also benefit from personnel which have experience with the target markets culture, especially if this model already indicates that the cultural differences will be big further research should be done. (Czinkota, Ronkainen & Moffett 2009, 42-43)

2.4.3 Politics and governments

Political decisions can have positive or negative influences on the micro and macro-economic environment, especially when a company tries to internationalize its business the political environment is crucial to understand. On the national level governments can influence sectors like the labor market, how flexible personnel can be hired and dismissed, also subsidies are used to either protect certain industries or enhance competition. The political environment can also affect the internationalization process of companies by their tax regime, governments can grant tax benefits for certain areas and periods to support companies to build up business operations.

2.4.3.1 Political views

Different political parties support different economic systems, when evaluating markets of interest the key for success is to assess and adapt to the local environment, not just in terms of culture but also in terms of politics. Businesses, especially small businesses, should try to avoid getting involved in politics in any way, it might be beneficiary for the moment, but in long run political majorities can change and lead to negative effects. A certain distance to political parties and members of political parties should be taken as granted, even so political systems especially when dealing with dictatorships and communist countries need most likely closer contacts to government officials due to strong influence of the state-economy and the centralized decision making in those environments. (Albaum & Duerr 2011, 218, 222 - 227)

2.4.3.2 Political risks

Companies which want to participate in international expansion have the chance to be rewarded with higher growth and higher profitability; on the other hand they have to face problems related to political risk, because depending on the markets which want to be entered the political establishment might cause problems for those businesses.

Especially the transitional economies like China and Russia have a long history of communism which shaped the societies; even they opened their economies over the last decades the political establishment is still in force, especially talking hereby about the biggest emerging market China. Political unrests can appear suddenly, without long advance warning time like 1989 on the Tiananmen Square in Beijing, which heavily influenced the political environment in a negative way. Also changing political majorities are influencing the business life, especially if extremist parties are taking over the government, political unrests and the loss of the civil order can have negative influences on the daily business as well, over the last decades political changes, peaceful democratic movements took over in certain countries while vice versa especially in less developed parts of the world countries turned to autocratic regimes which in general have had devastating

effects on the local economy. Therefor the predictability of the political systems and its continuity plays a crucial role to develop a sustainable business environment. Regional conflicts can affect the business, high uncertainty regions like the middle east or southeast Asia are in the public mind when talking about this topic, but there are several regional conflicts all over the world which are influencing daily business due to trade wars, genocides and resulting expulsion of ethnical groups are also affecting the regional economy and therefor businesses which are operating in those countries. Political motivated terrorism also affects the business life; safety concerns might increase the costs of transportation, security and influence the demand for specific products. Especially since the terror attacks in the United States on 9/11 trade restrictions were put in force to protect the United States of America, not just the private life of many American citizens was affected, also the business environment changed dramatically, safety controls were put in force, wars were declared based on the need for safety, in short political motivated terrorism turned into a global phenomenon. (Morrison 2011, 234 - 237)

2.4.4 Crime and corruption

When internationalizing a business there are several legal issues which are important to know because domestic and foreign legislation might be different, also the acceptance and the way of doing business in other countries might vary significantly from the domestic based operations. Therefor it has to be seen as a crucial factor to gain a deeper understanding of those issues.

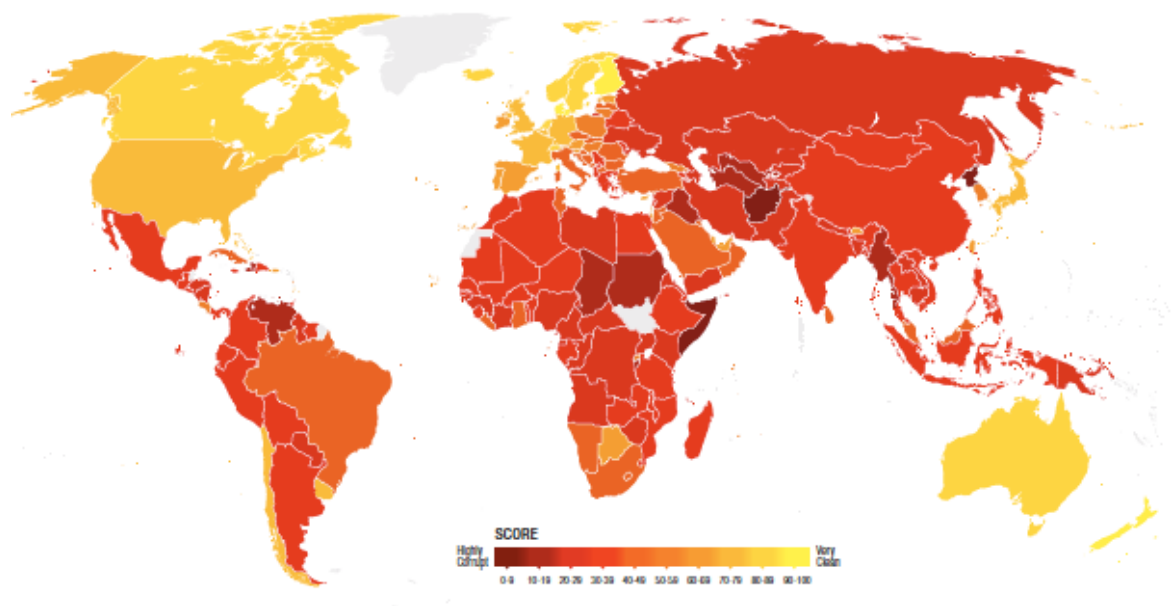


Figure 2. Corruption intensity by country

The degree of corruption in business is highly dependent on the country where the business is from and where it is operating; because societies differ in regards what they consider as crimes or illegal actions. Keeping this in mind it is logical that crime prevention and law enforcement on bribery or other illegal actions is not uniform among countries. In some countries bribery and corruption are seen as normal and a part of business life. Considering the development of law enforcement and acceptance of it, there is a clear trend to stronger regulation and harsher law enforcement combined with higher punishments over the last decades in many countries. (Everett 2012)

In Germany bribes in international business were tax deductible until 2002, as long as no bribes were paid in the domestic market the tax system supported bribing foreign companies to enhance international business. The German tax law regarded bribes as “useful expenditures” which were tax deductible as “advertising expenses” until 2002. The European harmonization process led to a shift towards a stricter legislation. (Möllering 2004, 1-3) Today Germany is

following a strict law enforcement which is punishing all bribes, on this example it is easy to understand how environments can change.

Nowadays western societies have a more common understanding at what is regarded as illegal, on the other hand we have countries, especially in Asia and Latin America where bribery and corruption are still an integral part of business life. Bribing and corruption can be seen as a market distorting action which makes foreign companies less competitive in markets with high levels of corruption. It is important to know that the law enforcement and related criminal actions are not corresponding with the political system, the United Arab Emirates as a monarchy is less corrupt than India or other democracies. Scandals and the general public awareness, as well as the acceptance of the legal institutions are directly linked with the degree of corruption. (Albaum & Duerr 2011, 232)

Companies nowadays have self-imposed codes of conduct, generally known as corporate social responsibility, where they explain the ethics the company is following in terms of business. Especially companies listed in the USA are keen on being corruption free, because the ENRON case increased the public awareness as well as the penalties for corruption dramatically; it led to stricter law enforcement which should prevent criminal actions in the future. (Cotter 2002)

2.5 Selecting the entry mode

After analyzing and selecting a target market a company has to choose via which way they want to enter this specific market. There are several market entry modes that can be used; all of them offer certain advantages and disadvantages which have to be analyzed and considered. Those entry modes offer the possibility to select the degree of risk which will be accepted. Especially for SMEs it is important to understand this fact of internationalization, expansion abroad always involves taking risks to some extent, and just the amount of risk can be varied. On the other hand risk goes with possible profits, when a company's tries to reduce their risk the possible profits might be lower as well. There is no perfect way to enter a market, because every market is unique and the process of accomplishing a market entry

is very complex, therefore the entry modes which will be described just give the foundation for the further selection process depended on the company's resources in terms of finance and personnel. (Root 1994, 28)

2.5.1 Exporting

For small and medium sized enterprises exporting, direct as well as indirect exporting might be a good way to expand on an international level. If a company produces and sells the products itself to customers abroad it is called direct exporting, while if the company is selling the products to an intermediate and this organization sells them overseas it is called indirect exporting. (Kotler & Keller 2012, 624)

Exporting offers the possibility to penetrate new markets with low risk, combined with low financial commitments. Additional to this it offers the chance to generate economies of scale for already existing processes, because just the production level will increase, fixed cost processes like human resource planning, enterprise resource planning etc. will not be heavily affected by exporting. The impact on the organizational level is very limited, since the current structures of the organization do not have to be broken up for exporting. Another advantage is that due to the nature of exporting the know-how will not be transferred to foreign markets. (Root, 1994, 75 -77)

Even though there are many advantages there are also disadvantages which have to be considered, especially the process of exporting might be challenging, depending on the country where the exports are going to import barriers as well as export barriers might be a problem. Countries might protect their domestic market by placing import tariffs on certain product categories, which put the selling price in those markets higher for imported goods; this might lead to prices that are not competitive anymore. Another factor is that products, especially those concerning nuclear energy and weapons, are seen as matter of national security and exporting might be prohibited or need a special permit which is based on the allowance of the government. When a company does not have the ability to carry out the export

procedure themselves many external partners are needed and this has to be coordinated. When operating in foreign countries without company's own sales office there also might be problems with service, especially customer support might be challenging due to the geographic distance. If the target market is not in the same currency area the exchange risk can be a problem due to depreciation or appreciation of currencies which also affects business and especially its profitability. (Root, 1994, 77 -78)

2.5.2 Licensing

Licensing is another way of entering foreign markets; it is based on an international licensing agreement between the licensor and the licensee. The licensor is granting the right to produce products, including related intellectual property rights, for a fixed time period in a certain country and in return a royalty payment or a certain percentage of the total sales will be paid. Licensing as an entry mode to foreign markets enables even SME with no available financial assets to expand abroad because the licensee is responsible for the manufacturing, marketing and the customer service in the new market. The licensor company is able to generate extra income because the license grants the right to use its know-how; it is an effective way to expand the business to foreign markets without taking much risk or investing a lot of capital. Especially for companies which do not have knowledge or resources to expand abroad licensing is promising. (Hollensen 2011, 358)

Licensing also has disadvantages which have to be mentioned. The possible income is much lower compared to other market entry strategies. Additional to this it might be possible that due to poor quality standards of the licensee the products might be of bad quality which can affect the image of the licensor in a negative way. In the worst case it will not just put the brand image at risk but it also can be that the licensee turns to a competitor, if the contract does not have clear limitations. Another issue is that after the license terminates the know-how stays in the company and might enhance the competition which can lower the

profit margins in long run. Considering those facts it is advisable to give licenses only to companies where mutual trust exists. (Kotler & Keller 2012, 626)

2.5.3 Franchising

Franchising follows a similar approach to licensing, a contract between the franchisor and the franchisee grants the rights to use trademarks and products to the franchisee. The difference is that franchising is based on a broader field, it does not just include the rights to use the company's name but the franchisor most likely offers centralized marketing activities. The time horizon for franchising is longer or even unrestricted, because after entering the franchising agreement the aim should be to generate a long-lasting win-win situation for both parties. (Hollensen 2011, 363)

The advantage of franchising is that the franchisee is only responsible for running the actual stores; due to the standardized processes the quality most likely will stay the same. It is an inexpensive way to expand the business to foreign markets, because the franchisee has to pay royalties for the centralized services of the franchisor. The franchisor gets additional revenue and profits out of operations. It is also possible to enhance internationalization on areas which normally are not open to exports or foreign direct investments, as long as there are no restrictions in terms of capital transfer.

However, franchising also has disadvantages which have to be mentioned. It is possible that franchising companies are not following these standardized processes and quality problems might harm the franchisor's image later on. The franchisor has to be aware that centralized processes like marketing, brand management, strategic planning should not be shared with the franchisee because this bears the risk of creating a competitor in the same field of business. Another problem of franchising is that it is not possible to use this entry mode in certain business fields. (Hollensen 2011, 365 - 366)

2.5.4 Joint ventures

It might be appropriate to use partners from the target market via a Joint Venture; those partners can give valuable information, knowledge and even capital to enhance the internationalization process. Joint ventures are becoming more and more popular, especially considering the Chinese market where direct market entry of companies is restricted.

A joint venture means two or more companies which want to combine their knowledge in a new legal entity which is owned by single parties. This gives the advantage that the risk of entering a new market is shared among the different owners of the joint venture; it also reduces the risk of failure because if local partners are involved the market knowledge is higher than without them. Depending on the company's profile, joint ventures offer the possibility to generate high profits, because the company which wants to enter the market can offer superior technology while the local partner can contribute via market knowledge, capital or production facilities. (Kotler & Keller 2012, 627)

Considering the fact that the company is owned by more parties, knowledge as well as technology will be shared and this might cause problems in the long run. Most likely the local partner is operating in the same business field, if the joint venture is given up, or the partner leaves the joint venture after some time the technological know-how which was gained during the joint venture can be used, it might be that a new competitor is just rising because of the knowledge transfer of the joint venture.

2.5.5 Foreign direct investments (FDI)

FDI is more risky, but also more promising at the same time. When talking about foreign direct investment as an entry strategy a company needs a deeper commitment to the target market than with other entry modes, because in general a long planning period before the actual FDI is needed. The start-up procedure is also longer than with other entry modes because the company needs to deal with different issues like regulations of the target market and restraints of the planning bodies. The biggest problem of FDI in general is in establishing a proper financial

plan which deals with uncertainties and possible losses which might occur during the initial stage of the FDI. Even though there might be a problem the FDI is a well-accepted and often practiced way of expanding business abroad, due to the fact that it offers full control over the operations. It also gives the advantage of offering better service to the customers; additional to this it will minimize the transportation costs because local suppliers can be used. In some countries it also might be beneficiary to be able to use the local country label e.g. made in the USA for the US market, because of image reasons. FDIs can be separated into two different categories which are following a different approach. (Kotler & Keller 2012, 627)

The Greenfield investments are about creating facilities like factories or service centers in foreign markets. Depending on the field of business it might be possible that the local government gives incentives like subsidies, free land plots, tax reliefs etc. for such an entry strategy. The advantages of Greenfield investments are the full control over the facilities, the management and the marketing. (De Búrca 2004, 394)

An acquisition of a local company is also a foreign direct investment, in this way the purchasing company gets instant access to the target market. The advantages are that there is already an existing customer group and additional to this the market knowledge is the highest compared to all other entry strategies. With the company its personnel is generally taken over as well, means that a working team of employees can directly continue operating, the product range can be modified, switching from the previous products to the new parents company products or simply add them as new product categories to the current sales mix. The problem of acquisitions is that the new company has to be integrated in the company structure; cultural differences might harm the smooth running of the operations. Another problem is to decide how independent the company will stay, ranging from keeping the local managers with large autonomy or putting parent company managers in key positions. (Hollensen 2011, 394)

2.6 Financing of the internationalization

There are several ways of financing the internationalization of businesses, but it always depends on the financial strengths of the company, as well as the entry mode which was picked. Companies can use their own capital, or leverage themselves with credits. Another way which is likely to take more time but is seen as less risky one is to issue more shares on the stock exchange if the company is listed there or to do an initial public offering which in return gives capital for further expansion.

When talking about the easiest way of financing the international expansion, using the equity capital of the company, we have to consider that equity capital is generated by past profits which were accumulated. Companies try to maximize their profits, if the opportunity costs are higher than the possible return the company's own capital should be used for the international expansion, the problem is that not many companies are able to completely finance their internationalization by their own capital, especially considering that waste amounts of money will be needed when entering using foreign direct investments into new markets.

Another way of financing the internationalization would be by leveraging; meaning loaning from a bank would be one possibility. The problem is that the company in the future will have to pay interest on those loans. Especially the interest rate situation should be studied carefully, because even though credits might be cheap at the moment it cannot be predicted where the interests will stand in the future when the old credits have to be refinanced. (IHK Reutlingen 2011)

Companies can also place bonds on the stock exchange to collect private capital; this method offers the possibility to get capital at lower interest rates as long as the company is healthy and has a good credit rating, which is based on different factors like liquidity, gearing and the general evaluation of the company. Bonds also have the advantage that if their value is dropping the company can buy back the bonds at a lower price, which means that the overall money which has to be

paid back is lower than the initially collected money. On the other hand, there are disadvantages as well; the bonds have to be placed by banks which charge a fee which varies depending on the size of the placement. Bond placements with small volumes are generally not as advantageous as bond placements with high volumes, because the fee does not depend on the size of the placement. Additional to this bonds have a fixed coupon which equals the interest on the initial price, therefor they generate a negative cash flow for the company itself. (Investorwords 2012)

Companies can also finance their internationalization by going public, meaning that they are doing an initial public offering. Through this method the capital of the company can be increased while the ownership situation of the company is changed. It offers a great chance of accessing capital without leveraging; the company is just gaining capital without acquiring liabilities. The main problem related to IPOs is that a company has to pay fees to banks; another obstacle is the stricter financial reporting which is related to companies listed on a stock exchange.

2.7 Corporate structure changes

Depending on the size of the organization and the chosen entry mode a change in the organizational structure of the company might be beneficiary. In a domestic environment business is simpler, in the international arena companies have to face problems in regards of coordinating the single business units if they establish subsidiaries abroad, the distribution of physical & human resources to the single markets will be more challenging. Considering the size of SMEs it might be that the decision power is highly centralized, but this might not be the best solution. There are different organizational structures which have advantages and disadvantages, the company should adapt always the most suitable one for the current and future business.

The first organizational structure which will be dealt with is based on functional departments. Most likely those businesses are domestically oriented and only have

one or a few different products. In those organizations the functions are the key essence, depending on the field of business different functions are seen as more important than others. A problem resulting out of this structures is that the single departments might be not interconnected with each other, the departments can turn in-ward looking and therefore the “throw it over the wall” mentality can appear, where different apartments do not follow a big overall strategy but instead just focus on themselves and their targets. The top management is responsible for coordinating the departments. Another problem resulting out of this organization structure is that there might be problems if more products are sold to different markets, because in this case the different functional departments cannot specialize, therefore this way of organizing the business is seen as not appropriate for internationalization business. (McShane, Von Glinow 2010, 396)

Another organizational structure is the divisional structure, also called the multidivisional structure. It is following a decentralized approach where divisions focus on certain products or regions. This structure offers the advantage of having a decentralized decision making, depending on products or regions. Every division is led by a division manager who is responsible for the performance of all departments belonging to the division, e.g. sales manufacturing, purchasing and financing. It gives the chance to fully focus on certain regions, if the divisions are based on the area or on certain products if the divisions are based on the products. Anyway, both ways enable a concentration which allows further customizing than with other strategies. The disadvantage is that there are multi departments with the same tasks; therefore this approach needs a certain size of the company to overcompensate the additional costs. (Morrison 2011, 180 - 181)

The third organizational structure which will be dealt with is the matrix structure, the difference between the divisional structure and the matrix structure is that while in the multidivisional structure the division just focuses on a region or a product, the matrix structure focuses on both lines at the same time. The two lines of management, product division and regional management have to work together to find a common agreement what to do, the problem resulting out of this

approach is that it might not be possible to work together, that the ideas might be too different and therefor a deadlock might occur. On the other side, if it is performed in a proper way it offers great flexibility and the chance to use international product management combined with the possibility to react to local trends. (Morrison 2011, 181 - 182)

There is no perfect corporate structure, because enterprises are too diverse to put patterns over all of them and generalize it, most of the companies are not following a strict organizational structure, it is natural because those structures are based on the previous decisions of the management and the history how the company grew to its current size.

3 EMPIRICAL STUDY

The empirical research is based on the preoccupied knowledge of the literature review. The empirical research should give in detail information about the internationalization process. During the research a qualitative as well as a quantitative research method will be used to tackle the essential questions of the research problem. The empirical research aims at providing generalizable data which helps German companies during their internationalization process. Additional to this validity and reliability of the research will be discussed, because without valid and reliable results the research would not fulfill its aim to be applicable to all SMEs.

3.1 Validity and reliability

There are different ways of designing, creating and implementing researches, even so all have something in common, their aim is to generate reliable and valid results which are necessary for researches to reach a high level of credibility. Those two factors, reliability and validity are influenced by several factors which all have to be taken into consideration to prevent errors in the different stages of the research process.

3.1.1 Reliability

To get an understanding what reliability actually means the term needs clarification. In general it can be said that reliability is “the extent to which results are consistent over time and an accurate representation of the total population under study is referred to as reliability and if the results of a study can be reproduced under a similar methodology, then the research instrument is considered to be reliable.” (Golafshani 2003, 598) Therefore the focus lies in the repeatability of the results; reliability measures the consistency of answers to a certain question. If the results are reliable the results should be similar or even identical over several trials of a research.

It has to be seen that qualitative and quantitative research methods are different and therefor also the measures to achieve reliability have to vary. The reliability of the survey can be increased by the absence of participant errors, as well as a participant bias, especially the influence of the researcher is a critical point which have to be mentioned as well. The participants of the survey should not be led to certain answers. If the contact between the respondents and the researcher is reduced to a minimum amount the research will gain reliability. Also pretesting of the survey can increase the reliability, because problems related to the structure of the survey will be found in advance, especially talking hereby about the clear meaning of the questions and answers. (Sarmah & Hazarika 2012, 512)

While in quantitative methods the reliability can be measured, for qualitative researches it is a vague term, it is more related to the quality of the research itself. The quality of the research proves the reliability. (Golafshani 2003, 601 - 602) Overall we can also determine reliability for qualitative methods in the way that if other researches use the same methods and perform the research in the same way while coming to the same results and conclusions than in this case reliability is given. To increase the reliability for qualitative methods it is necessary to eliminate the human influence as far as possible. This means that the data collection should be standardized, a proper documentation of the research process is also necessary to ensure that other researchers can do the procedure similar in their researches to finally prove reliability.

3.1.2 Validity

Validity determines to which degree a finding was interpreted in the right way, if the findings of the study are accurate and truthful or not. Validity should not be confused with reliability, because a study can be reliable but not valid. Studies have to be fully focused on the research objective to be valid.

By using quantitative methods in the research the validity is “the initial concept, notion, question or hypothesis that determines which data is to be gathered and how it is to be gathered”. (Golafshani 2003, 599) There are several factors like

pretests, maturity effects; mortality effects, problem statements as well as the selection of the respondents which can affect the validity. Several measures can be taken to increase the validity of a research, especially expert expertise; proper documentation and pilot tests are commonly used.

Qualitative research can be described as subjective because the data have to be analyzed by human beings which are never purely objective by their nature, therefor the judgments of validity needs more measurements. The validity can be evaluated by five different subcategories, just if all subcategories are fulfilled the research can be regarded as valid. “Descriptive validity, interpretive validity, theoretical validity, generalizability and evaluative validity” are the factors contributing to the overall validity. (Thomson 2011, 78 - 80)

3.2 Quantitative study

This subchapter deals with different aspects concerning the quantitative research, it includes the research method which will be used, the implementation process as well as the population which will be researched. Later on the analysis of the results will provide generalizable information about which problems SMEs have to face during the internationalization process.

3.2.1 Surveys as a research method

The quantitative research is based on a survey; via this survey it will be possible to gather information related to the research problem. The advantages of surveys are, that it is possible to conduct information in a standardized way, therefor the objectiveness is high, with questionnaires it is also possible to achieve a large sample size which can be analyzed with statistical methods, single questions can be combined to get a broader picture as well as a deeper understanding of the correlations between the single variables. Even so this research method has disadvantages, because of the high standardization, explanations and other opinions towards single questions are limited, to fight those issues open ended questions might be advisable to gather specific and personalized answers. Another

problem is that the respondents are skipping the questionnaire when they realize that the questionnaire turns out to be longer than expected. Therefore surveys should not exceed a certain number of questions; the best approach tackling this problem is to make the questions precise and directly related to the research topic to avoid unnecessary complexity.

Surveys can be seen as tool for the purpose of collecting opinions, descriptions, attitudes based on the cause and effect principle. Even surveys are based on logical answering, there are different factors which influence the surveys result, talking hereby about the sponsor, its appeal to the person to whom the survey is addressed to, rewards but also the surveys layout and design are factors which have to be considered. As a quantitative method surveys “emphasis on testing and verification, focus on facts and/or reasons for social events, [follow] a logical and critical approach, [enable] controlled measurements [and] focus on hypothesis testing”. Via an analytical survey it will be possible to test the theoretical framework by “taking the logic into the field”. (Ghauri & Gronhaug 2010, 105 - 119) In this research it means that the internationalization process and the underlying theories will be connected with the real business life to proof them and understand the impact on daily operations of small and medium sized enterprises.

3.2.2 Implementation process

A questionnaire is more complex than most of the people might think. Different aspects have to be considered, especially the different aspects of the questionnaire implementation process are crucial to guarantee a proper outcome.

First of all the questionnaire has to be designed, it is important to link the single questions of the survey to the theoretical framework and the underlying research problem. The “red line” between both, literature review and the actual research is the key to success. The questionnaire in this research is focused on the internationalization process of SMEs from Germany and about challenges they have to face during the internationalization process. Altogether 18 questions are used to get data directly related to solve the research problem. The questionnaire

will be split in two separate parts; the first part is about the general information dealing with background information about the specific companies while the second part is about more in-detail information concerning the actual international process and the experience gained during it. It has to be seen that the questionnaire is designed in the way that it matches the topics of the theoretical framework which is dealing with the single steps contributing to the internationalization process and its challenges.

The second step is to test the questionnaire; this means that a small questionnaire test is done before the main research is conducted. This helps to detect problems which were not be able to be recognized during the drafting process. Especially the input of those respondents who answer the questionnaire first is crucial to increase the overall quality of the research, because language problems or a different understanding of questions can lead to a less reliable result. Feedbacks from respondents have to be seen as a key contributor for the quality of every research.

The third step consists of remodeling the questionnaire based on the results of the pre-test. After those adjustments the questionnaire should be able to be understood in a definite manner. Additional to this the questionnaire now should be able to provide accurate results, changes which were done should be discussed with participants of the pretest as well as experts in the field of marketing. Especially if the questionnaire has to be translated, native speakers or authorized translators can give further valuable adjustment suggestions how to build a consistent questionnaire in a foreign language.

The fourth step is about the data collection, this can be done via several ways. A questionnaire can be put online, where several respondents are invited to answer it or via mail by sending out envelopes etc. Based on the attractiveness of the topic, as well as the benefits which arise out of answering it the amount of responses can vary significantly. The response rate of questionnaires can vary significantly, to achieve a high response rate several incentives can be handed over to participants, e.g. cash incentives, or non-monetary gifts. Another way to increase the response

rate is by sending reminder letters or by stating personal reasons which might influence the receiver of the questionnaire to answer it.

In the fifth step the gathered data will be analyzed, a set of tools like statistical methods as well as graphics can be used to examine the results. Considering the fact that questionnaires can provide large sample sizes, it is advisable to use the mentioned statistical methods which enable the researcher to link several questions. It is not just important to see the answers to specific questions, it is even more important to link those single variables together, because the underlying relations might result in new findings. Graphics are also a commonly used way to analyze data, because visualization enables the reader of the research to get an understanding of the single variables more easily.

The sixth step deals with the reflection of the results. The analyzed data provides new input which should enable the research to solve the research problem; based on the literature review the reflection of the results can provide different outcomes of the study. During this reflection process it is important to know how to evaluate the results which were analyzed and put them in an overall context. It is crucial to see that the reflection of each research is always of subjective nature.

3.2.3 Population

To determine the population and the problems related to it is a crucial part of the quantitative research. This research focuses on German SMEs (based on the SME definition of the European Union). Even the study focuses on researching the internationalization process of SMEs, larger - already internationalized companies can also give valuable input. Those companies already went through the internationalization process; therefore they have a deeper understand of the challenges and how they can be tackled. Considering this fact the overall population contains SMEs which are domestically operating, SMEs which are already internationalized as well as larger companies. The population has to be big enough to achieve generalizable results. Due to this fact different privately organized business clubs were asked to participate in this research, additional to

this a large number of companies were directly asked to participate is this research.

Problems related with the nature of the population as well as the research process are that not every company has internet access, additional to this the survey might be regarded as unimportant for the population and therefor simply skipped. It also is possible that the results will be influenced by the interest and affinity towards internationalization, an overrepresentation of companies which are already internationalized or plan to internationalize might be the result. Another problem is that companies which failed in the internationalization process might not be able to reply the questionnaire anymore. Also the geographical area, where the companies are located can influence the answers concerning the internationalization, because companies which are close to a border can easily internationalize because of the geographic proximity.

3.2.4 Analysis of the Questionnaire results

Considering the response rate of the questionnaire a satisfactory result was generated. The questionnaire was sent to over 450 companies. Considering this, the response rate based on 76 responses is around 16%. The relatively high response rate was generated by two reminder letters which were sent to the same sample. Additional to this the cover letter for the questionnaire described the importance of this research, the purpose and how the results will be beneficiary for other companies which plan to internationalize their operations.

3.2.4.1 General information

General information are important for understanding the companies. Different aspects have to be considered to evaluate the results of the internationalization process which will be analyzed later on. Therefore different key figures will be explained to give an overview about the size of the responding companies, their competitive strategies, how long they have already existed as well as their evaluation of the international and domestic demand for their products.

Company size

The first question concerning the general information was based on the need for determining the size of the enterprises. Therefore the EU definition of SMEs, as shown in table 3, was applied. It has to be seen as very important to differentiate between SMEs and larger corporations in this study. Two questions were combined to analyze if the responding companies can be regarded as SMEs or not. The results of this question influence the study; therefore the questions were placed straight at the beginning of the questionnaire.

Table 3. SME definition of the European Union

Enterprise category	Ceilings			
	Staff Headcount (number of persons expressed in annual work units)	Turnover	Or	Balance sheet total
Medium-sized	< 250	≤ € 50 million		≤ € 43 million
Small	< 50	≤ € 10 million		≤ € 10 million
Micro	< 10	≤ € 2 million		≤ € 2 million

The EU definition for SMEs is based on the size of the workforce as well as the revenue the company can generate. Therefore two questions were asked, the first question focuses on how many people work in the company and the second was about the revenue stream. The combined result is shown in figure 3.

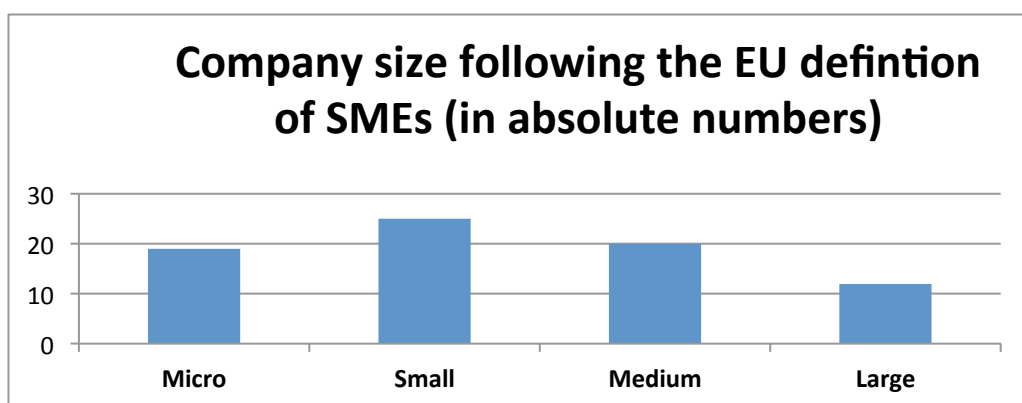


Figure 3. Company size

In figure 3 it can be clearly differentiated between companies which belong to the SME group and which are already too large and fall out of the definition. SMEs in total account for 84% of the respondents, while large companies are responsible for 16% of the responses. Micro sized companies, which are defined as companies with up to 10 employees and revenue up to 2 million Euro, account for a quarter of all companies which answered the questionnaire. The average responding company is on the upper limit of the small company definition. It is also important to see that there is no group overwhelmingly dominating or underrepresented in this research. Small sized enterprises account for one third of the total responses, which makes them the biggest group in this research. Considering the fact that there are considerably more SMEs than large companies in Germany the distribution can be seen as matching to the overall distribution of the German Mittelstand.

Competitive strategy

Companies can be successful because of different competitive strategies. The competitive strategies are influenced by size of the companies and the degree of specialization. 58% of the SMEs focus on a niche market strategy, this means that they emphasize on small markets where they can highly specialize. Via this way they can escape direct competition with larger companies. Another result from figure 4 is that 30% of the responding SMEs follow a differentiation strategy, therefore this strategy also looks fairly interesting for small and medium sized enterprise while the cost leader strategy is the least popular and just practiced by 12% of the responding SMEs.

What competitive strategy does SMEs and larger companies use?

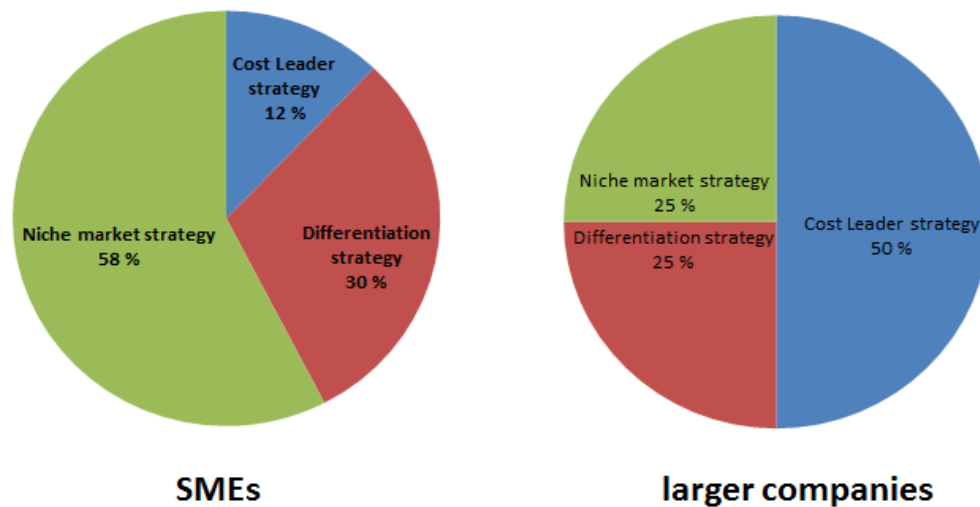


Figure 4. Competitive strategies

Comparing the niche market strategy and its direct counterpart, the cost leadership strategy, it is used nearly five times more often. This indicated that due to the size of SMEs the niche market strategy clearly has advantages compared to all other strategies mentioned.

Analyzing the competitive strategies of larger companies we nearly have a reversed preference. The niche market strategy and the differentiation strategy are both chosen by a quarter of the companies while half of the larger companies chose the cost leader strategy. Considering this strong discrepancy the size of a company seems to influence the competitive strategy which will be chosen. Even so, it is hard to determine if the size of a company is a reason or a cause for the decision. It was ruled out in the theoretical study that a certain size is necessary to use the cost leadership strategy, it was also mentioned that SMEs generally prefer other competitive strategies to be successful. The distribution of the responses support the underlying theories.

Years of foundation

The German market itself and its history is quite unique, different periods and events have had different influences on the economic development as well as the possibility of insolvencies during those times.

In the past 150 years the German economy was devastated several times, during the world wars, the great recession and the foundation crises. All those events lowered the possibility that companies exist still today. Due to those problems the distribution of the years of foundation is typical. For the analysis the years of foundation were split into four categories, three of them 50 years long and one from the year 2000 until today.

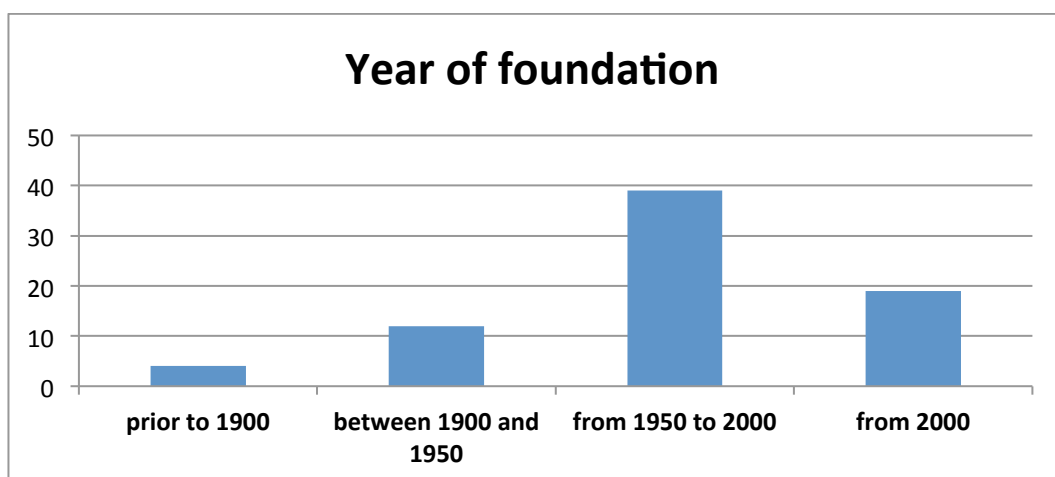


Figure 5. Year of foundation

In figure 5 it is interesting to see that just four companies which participated in the survey date back prior to 1900, those very old companies are all SMEs. The highest number of total answers as well as the leading relative bracket is for companies founded from 1950 to 2000. Nearly ten times more companies founded between the years 1950 to 2000 answered the questionnaire than companies which date back to prior 1900. Unexpectedly the number of companies established after the year 2000 was 60% larger than companies set up between 1900 and 1950.

Most of the larger companies which are not falling under the SME definition anymore launched their business between 1950 and 2000. This result seems to be reasonable because of the so-called “economic miracle” which lifted Germany out of poverty. This period offered tremendous opportunities for establishing and growing enterprises.

Among SMEs the picture is different, the time period with the highest SME respondents is between 1950 and 2000 as well, but the difference is that the relative distribution varies significantly. Among larger companies the relative distribution for this time period is 70% while for SMEs it is 50%. Taking a look at the differences of the other brackets a clear differentiation can be done, 10% of the large businesses were founded in the 2000s, and, on the other hand, 28% of the SMEs were established during this time.

Value creation by business sector

Companies can be service oriented or production oriented, even so a combination of both is possible. This is the reason why the question was formulated in the way that the sector should be chosen which contributes most to the revenue. From figure 6 it can be seen that 61% of the small and medium sized enterprises generate most of the revenue streams from manufacturing, while 39% are service based. Large businesses tend to have slightly higher service exposure while the manufacturing is less important for them than for SMEs.

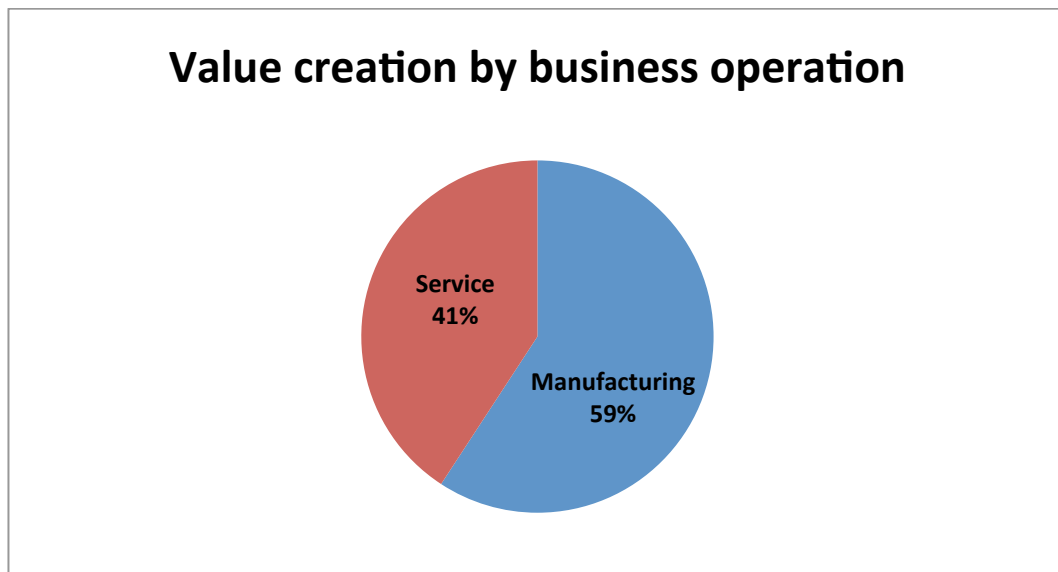


Figure 6. Service & manufacturing focus

One reason for this shift is that the service for products can balance the business growth. Long-term business contracts can generate continuous revenue streams while manufacturing is more dependent on the current economic situation. Another reason could be that the provided service needs more personnel and therefore the SMEs have a disadvantage in doing services based on their small size.

Demand analysis on a domestic and international level

The domestic demand is very important, because it shows how much products or services can be sold in the local market. If the domestic market performs well the pressure to internationalize is generally lower than vice versa. The domestic demand is a key criterion for companies and their future development.

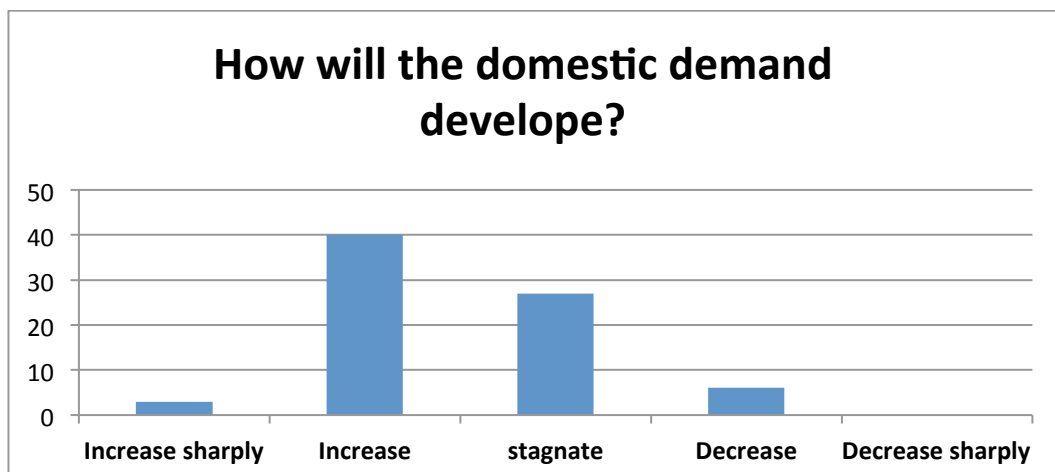


Figure 7. Domestic demand

The companies which answered the questionnaire have a positive perception of how the domestic demand will develop. Figure 6 states that just six out of 76 respondents think that the domestic demand will decrease, while 40 companies think that the domestic demand will increase. Three respondents even think that the domestic demand is going to increase sharply. Altogether 35% of the respondents think that the domestic demand will stagnate. The results have to be seen as snapshot of the current economic environment. The domestic demand in Germany is seen as robust at the moment.

Germany can be regarded as a “safe haven”, no fiscal austerity measures are planned for the future years and the overall economic situation seems to be robust. Altogether 56% of the respondents have a positive impression of the future domestic demand, while just 8% are concerned about it. Not a single respondent predicts a sharp decrease in domestic demand.

Internationalization is about entering foreign markets and therefore it is important to know perceptions of the companies about the demand prediction of those markets as well. International demand means the accumulated demand of every country in the world; therefore this question is used for a comparison between the

domestic and the international demand. It is interesting to evaluate how the companies see the discrepancies.

The main result of figure 8 is that the respondents evaluate the overall international demand as very positive, 74% of the companies think that the international demand will develop positively or very positively. Another 22% have the impression that the international demand for their products will stagnate. Just 4% of the companies think that the international demand will decrease in any way. A reason for this very clear distribution might be that the world economy is actually still running well, even though the global GDP growth slowed down it looks like that the demand for German companies did not slow down at all.

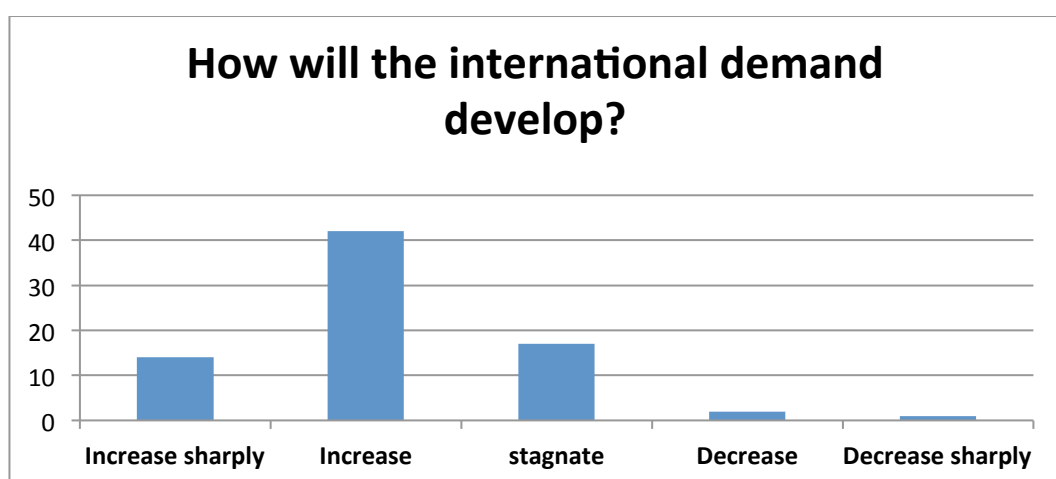


Figure 8. International demand

By comparing the domestic and the international demand it can be seen that the expectations for the international demand are much higher than for the domestic demand. Domestic as well as international demand are not predicted to slow down in the future, just the growth expectations differ from 56% on a domestic level to 76% in the international perspective.

Degree of internationalization

The degree of internationalization has to be measured according to the size of the enterprises; the results are visualized in figure 9 which can be found below. The overall internationalization rate, according to all respondents, is 63%, while 33% of the responding companies did not internationalize at all. The other 4% are not internationalized yet but they plan to do so. This overall distribution is interesting, but without splitting up the underlying data wrong conclusions might be drawn. Keeping in mind that the barriers for smaller companies to internationalize are higher a more in-detail analysis is needed.

The separation between micro, small and medium sized enterprises provides an interesting set of data. While 85% of the medium sized companies are already internationalized just 26% of the micro companies are. Among the small businesses already 64% are internationalized.

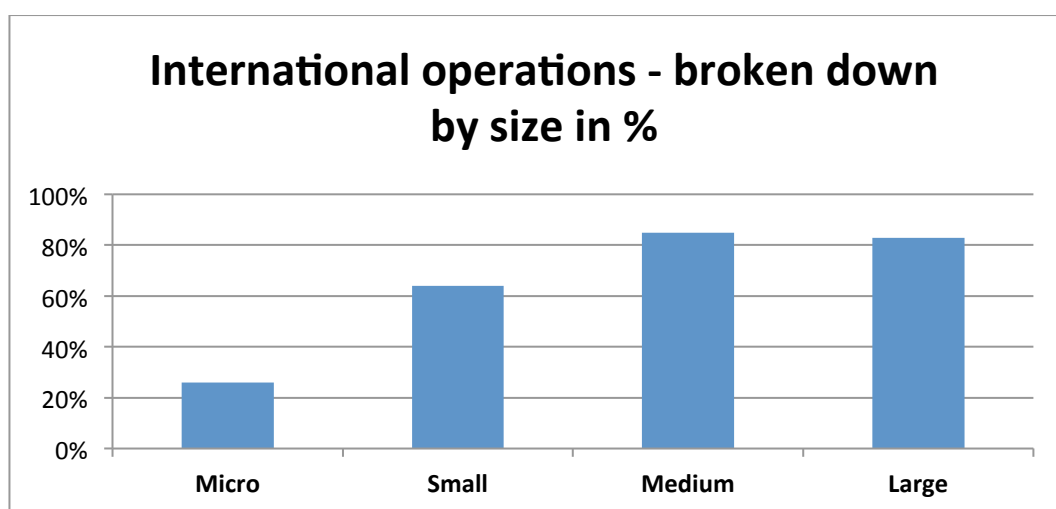


Figure 9. Degree of internationalization

Those findings indicate that the degree of internationalization is highly correlated with the size of the business. In the theoretical part of the study challenges of internationalization of SMEs were described, but it seems like only micro and small enterprises are really affected by them. Medium sized enterprises even show

a higher degree of internationalization than large companies. It seems that there is no big difference between medium and large organizations anymore; this might indicate that around of 80% of the companies can benefit from internationalization while 20% will not benefit from venturing abroad due to various reasons.

Reasons for the absence of international operations

Different factors are important when talking about the absence of international operations. Those challenges have to be analyzed to get the full picture why companies are not internationalizing their business.

First of all between internal and external factors can be differentiated. In the previous question it was stated that the size of the company is heavily influencing the internationalization decision, therefore it is advisable to differentiate in this question as well to get a deeper understanding of why companies are not venturing abroad. Micro, small, medium and large enterprises have to face different challenges. Especially micro and small business face problems, while medium and large enterprises are already internationalized to the largest extent.

One of the main findings, which can be seen in figure 10, is that medium and large companies are not internationalizing their business for internal factors. For both groups the top ranked answers were that they are simply not interested in internationalization while other factors were not mentioned. It seems like a certain size is neutralizing other negative factors which restrict the internationalization process.

Considering this the focus shifts to the small and micro companies which face different restraints. Cultural differences are not seen as important at all, because no single company chose it as a reason for not going international. Top level management restraints are also playing a subordinate role with less than 5% of the responses. However, it can be said that the lack of resources is the biggest problem which micro and small enterprises have to face. For small enterprises it is

the biggest reason why they do not venture abroad, 29% of the respondents chose this factor. The high risk of internationalizing and the lack of knowledge are seen as the second and third biggest negative influence factor, both account for 24% each. It also has to be seen that not every company wants to go international, nearly one third of the SME companies do not want to internationalize and instead focus on the domestic market. Top level management also plays a minor role, but with 6% of all responses it is seen as the least important factor.

Micro companies face nearly the same problems, but just to a higher degree. Because of their small size the risk of internationalization is bigger, also the lack of resources is a main issue related to why they do not go international; both factors make up 31% each of the responses. Micro sized enterprises are also less interested in venturing abroad in general, this factor just accounts for 24% of the responses. This indicates that the domestic market focus is much higher than among bigger companies. Last but not least the lack of knowledge plays a minor role and is just mentioned by 14% of the companies.

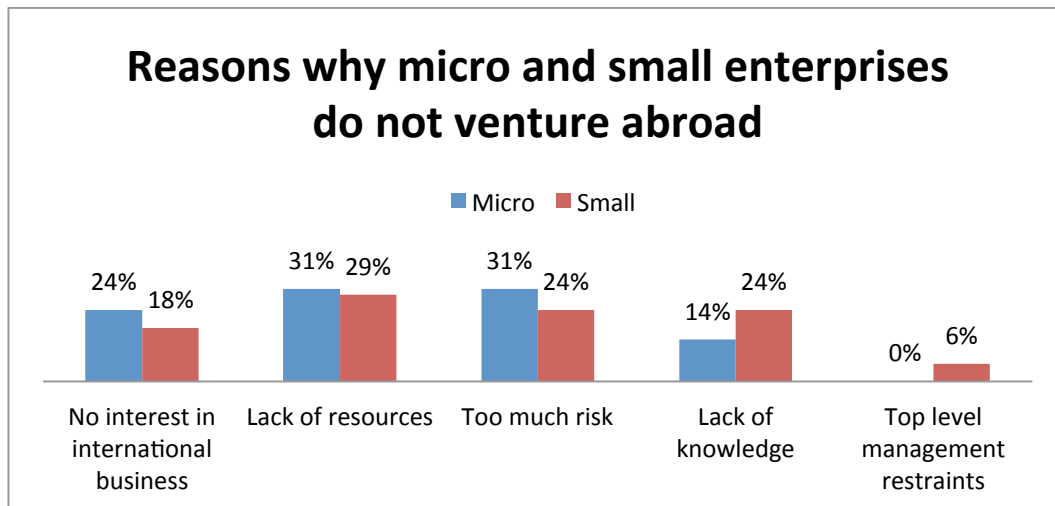


Figure 10. Reasons for the lack of internationalization

Altogether the different aspects mentioned above give an explanation why micro and small enterprises are less internationalized. The findings indicate that medium and large companies do not have to face the same problems as micro and small enterprises. In this case a clear distinction can be done based on the size of the

companies, because the reasons why they do not go abroad are quite similar among micro and small enterprises as well as medium and large companies.

During the analysis of the single aspects the need for further separation of the single variables based on the size emerged. The answers which were conducted have had to be split up to get an in-detail picture of the general situation. The logic behind it was that the business size is heavily influencing the different aspects and how they have to be evaluated. Single questions have had to be merged together to determine single factors, without this the findings would not be valid at all.

It also has to be kept in mind that not every company is facing the same problems; one of the main findings was that medium sized enterprises do not have the same problems like micro and small sized business. Different aspects have to be evaluated differently concerning the companies size.

3.2.4.2 Internationalization Process

For the second part of the survey only companies which already internationalized their business were asked to participate. The aim of this section is to analyze the internationalization process of the companies to get a better understanding of how they performed. Questions about how those companies determined the market attractiveness as well as which market entry mode was chosen will be analyzed next. The financing of the internationalization is also a part of this section, because it will provide information to which degree companies took risks.

Influence of internationalization

This section is about how companies evaluate their own performance based on the internationalization. The company's own perception of the performance should not be mixed up with the objective internationalization performance. This question gives the subjective opinion of the respondents.

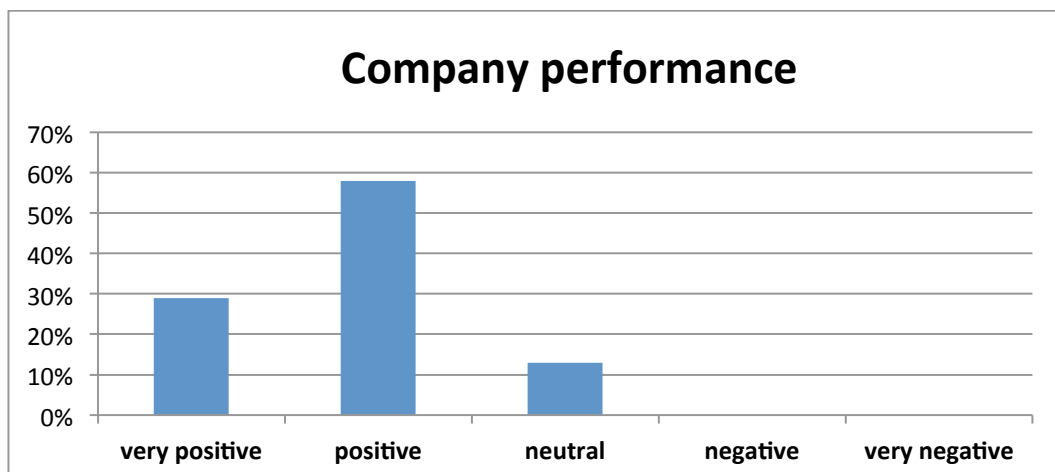


Figure 11. Company performance

In general it can be said that the respondents' perception of internationalization is very positive. 87% of the internationalized companies think that the company performed well or very well because of internationalization. Just 13% of them describe the impact as neutral. Not a single company has had the impression that internationalization has caused a negative impact at the company. Nearly 30% of the respondents think that the internationalization has had a very positive influence on business operations.

The ratio between the positive and the neutral answers is over 6, indicating that the overall satisfaction with the internationalization results is very high.

This can be caused by good economic performance of the target markets where those companies are operating in. The current perception of how the internationalization influences the businesses might change over time, especially if the economic situation changes in a negative way, considering the fact that during the years 2008 and 2009 many internationally operating companies were hit much harder than the domestic oriented. It is important to consider the positive world economic environment with the booming BRIC countries boosting international demand for products.

Preferred entry modes

Different ways of internationalization offer different advantages and disadvantages. Especially considering the size of the companies the selection of entry modes might vary significantly, it is also quite common that more than one market entry method is used over time.

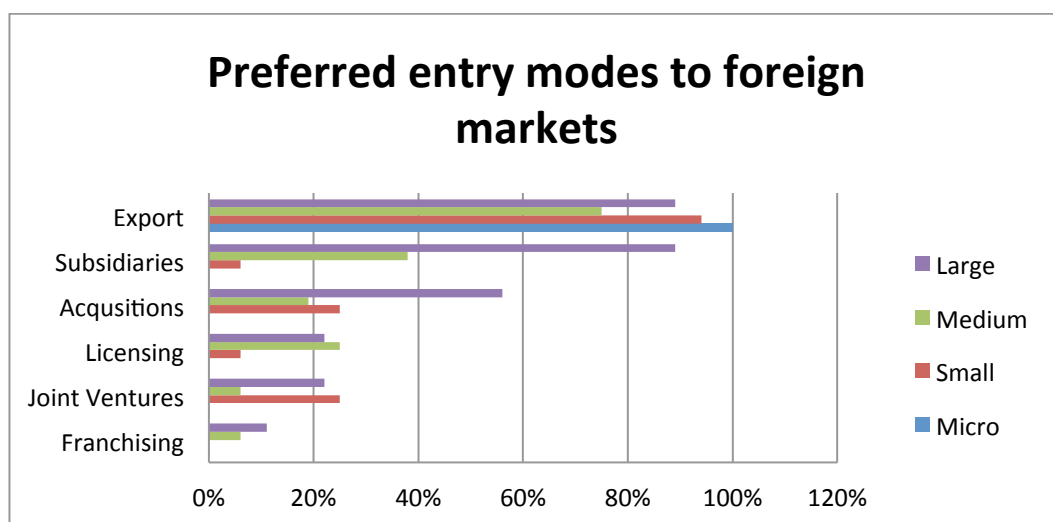


Figure 12. Entry modes which were used

The separation based on the size of the companies enables analyzing the preferences of micro, medium, small and large sized enterprises. In general it can be said that exporting is most commonly used method for doing international business, but on this point the similarities end.

For micro sized companies exporting seems to be the only choice which is acceptable. The findings for them are that they prefer exporting over all other methods which were mentioned. Due to the size other entry modes seem to be too expensive or too risky, especially considering the results from the previous questions this result is very reasonable.

When talking about small enterprises it becomes more interesting, because not just exporting is used but also already more complex ways of internationalization. Already 6% of the internationalized small businesses had established foreign

subsidiaries. Additional to this 20% of the respondents mentioned that they have already taken over companies which were not located in their domestic market or formed a joint venture abroad. Another 6% responded that they are licensing their products to partners abroad. Therefore small enterprises, even if their number is relatively low in this survey, are already taking advantage of the full set of entry modes excluding franchising, which is the most challenging one.

Also among medium sized companies exporting is the leading tool with 89% for going international. Even subsidiaries are commonly used. In addition to this acquisitions as well as licensing is fairly popular among medium sized enterprises; both were chosen by around 20% of the companies of this size as a way to internationalize. Franchising and licensing were also entry modes which were mentioned, but not many medium sized enterprises perform them.

Taking a look at the larger companies the expected picture occurs. Round about 90% of those companies perform exports and in addition to this foreign subsidiaries were established. Another way how the studied companies venture abroad is by acquiring a foreign company, which is also quite common with 56%.

Excluding exports, which is the most convenient and also the cheapest way of going international, all other entry modes need significant amounts of money as well as a risk taking attitude. Considering this the distribution is fairly predictable, because the size of a company generally influences the possessed financial strengths as well as the experience which reduces the risk during the internationalization process. Companies which are not able to finance foreign acquisitions or other entry modes are bound to exporting as their only way to go international. The natural growth of companies is causing the high rates for exporting, other entry modes are most likely used in a more mature stage of the company where the financial strength is already given. SMEs face disadvantage in this field because their financial situation as well as their lack of experience might not enable them to choose more profitable ways of entering foreign markets.

Reasons for venturing abroad

There are several reasons why companies go abroad, still so not every factor influence companies in the same way. During this section a general overview why companies venture abroad and the importance of the single reasons will be described.

It has to be seen that there is no one reason why companies go abroad; all single factors have different importance to different companies. In the following paragraphs the different reasons will be explained in detail to provide a deeper understanding of those single factors.

The reason with the highest impact is about profit and growth, via internationalization different markets can be entered, enabling companies to grow faster and be more profitable than with just focusing on the domestic market. Nearly 40% of the respondents see a strong impact of this variable as to why they have chosen to internationalize their business. Another 48% see a medium impact in this variable, just a minor share of combined 13% sees a low or no impact at all. Considering this distribution, the importance of growth driven internationalizations seem to be the most important factor concerning internationalization. In first instance companies try to generate growth, other factors are just of secondary importance.

Technological competence also has to be seen as a critical factor, because companies are able to exploit their know-how in a better and more efficient way. 40% of the respondents think that this factor is of high importance, while just 16% regard it as unimportant. It has to be seen that 84% of the internationalized companies see at least some importance in it. Especially the companies within generate their competitive advantage out of state of the art technology will be able to succeed more easily than others, because of their unique products.

Another important reason why companies go abroad is managerial urge, this means that the management pushes the internationalization because of their own

experience or because the management sees market opportunities. 33% of the responding companies regard this factor as very important for the internationalization; their impression is that the management support plays a crucial role. Another 59% see this factor as important in some way. Just a small minority of 9% do not see any influence of the management in terms of internationalization.

Economies of scale can be a reason for venturing abroad, because due to lower unit costs it can generate a competitive advantage for companies following a cost leadership strategy. Even so just a quarter of the responding companies see a strong or medium impact, while 75% of the internationalized businesses think that it has a low or no impact. This clear distribution can be partly explained by taking a look at where the companies which participated in this research see their competitive advantage. Just a relatively small number is following a cost leadership strategy in which unit costs are important.

Another reason for the internationalization can be that there are tax incentives, but at least for the respondents of this research this factor is not playing a crucial role. Not even half of the respondents see some importance in it. While 52% see no importance, a small group of 2% thinks that a tax incentive is a very important factor to consider when going abroad. A reason for this can be that in general SMEs and other slightly bigger companies are not using all the ways of tax optimization. It might be that very large companies are more aware of it.

If the domestic market is saturated, international exposure is seen a high importance variable by 13%. When including the respondents who see some importance the share grows to 76%. A reason for the low values of the high importance category might be that companies which internationalize their business search for growth in general, like in first paragraph explained and therefore it can be that companies already go abroad long before the domestic market is saturated and are not forced to go.

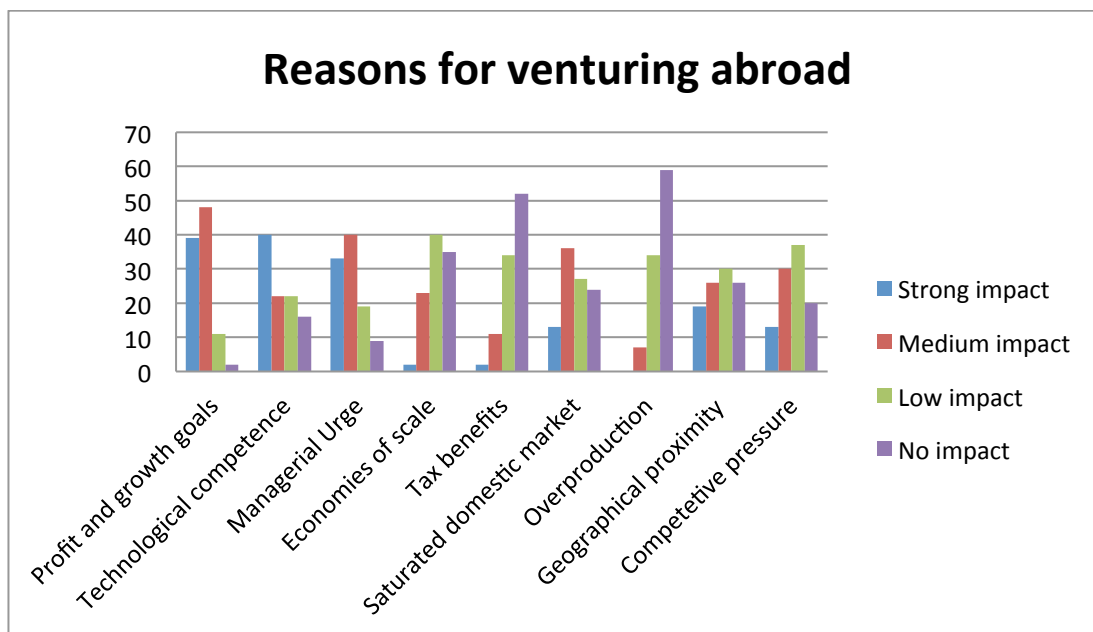


Figure 13. Reasons for the internationalization.

Overproduction can also be a reason for venturing abroad, if the products would not be possible to sell during a certain period at a certain price in the domestic market. This means that the company can search for other markets in which to sell the products. Overproduction is a temporary factor because of the modern supply chain system overproduction was reduced systematically. This might explain the low importance of this category. Over 90% of the responding companies replied that this factor is of low importance or no importance for their international exposure.

The geographical proximity to certain markets also plays an important role in the decision to internationalize the business. Nearly 20% of the responding companies ranked it as a factor with a strong impact. In opposite, 26% do not see any importance in it. Altogether 74% see at least some impact in it when they decided to internationalize. Even so the importance might vary from region to region; companies which are close to borders might evaluate this factor as important while other companies far away from national borders as unimportant.

Last but not least, the competitive pressure in the domestic market is seen as an influential factor by 80% of the companies. The relative distribution indicates that

this variable is more complex, just 13% refer to it as a strong impact factor. More than twice as many respondents regard it as a factor with low impact. Another 30% of the companies see this factor impacting them in mediocre way. Competitive pressure can go hand in hand with a saturated domestic market, therefore its relation between them is quite interesting. The relative distribution of the importance of both factors is quite similar. It has to be seen that both factors can influence each other to some extent.

Most promising markets

Before companies go international they have to evaluate which markets are the most interesting ones for them, therefore this question is necessary to determine where the businesses see the biggest possibilities. Because the companies' choices vary significantly based on the size, a differentiation between SMEs and larger companies was done to gain an understanding which markets are the most promising. Even if in the previous analysis the geographical proximity is not considered as a major reason for venturing abroad, it looks like that the geographic proximity of certain markets heavily influences their evaluation. SMEs clearly prefer European markets while larger companies, also called MNEs, in this statics have a more diverse perspective of where the most interesting markets are.

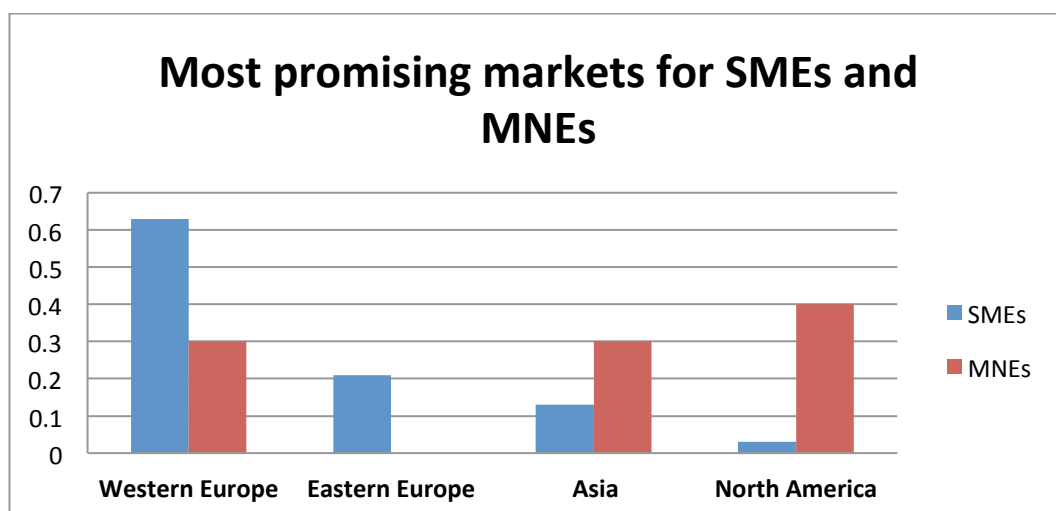


Figure 14. Target markets

It seems like that SMEs generally prefer Western Europe which is mentioned by over 60% of the SME respondents making it the most attractive market. Eastern Europe is also ranked quite high, but just slightly over a quarter of the smaller companies think that it is the most promising market. Even in Asia the growth rates are outstanding high, just a small minority of 13% think that the most promising markets are in Asia. North America seems to offer the least promising markets for SMEs, not even 5% think that North America can be regarded as interesting. Small and medium sized enterprises seem to favor European markets. A reason might be that even as Europe faces an economic crisis at the moment the total combined GDP output is still the largest in the world. Additional to this the European market is harmonized to the biggest extent, some economist even say that a new model of domestic market should be applied for the European market. The Schengen area can be regarded as an extended domestic market today, therefor the high ranking of the European market seems to be reasonable.

On the other side larger companies tend to favor markets which are further away, just 30% think that the Western European market is the most promising, the same percentage goes to Asia with the booming Chinese economy. North America which is unattractive for SMEs, is the most interesting continent to be on for the larger companies. The distribution is clearly favoring target markets which are further away from Germany, one of the reasons can be that those companies already entered the European market and therefore are searching for other promising markets further away.

Another factor which is not included in the chart is Oceania, it was not mentioned a single time. Based on the relatively small economic output and the long distance between Germany and Oceania it seems like that this market is the least attractive one even if the economic growth in Oceania over the last decades was much higher compared to other OECD countries.

Target market evaluation

When evaluating the target markets which are seen as most attractive ones there are several factors which have to be considered. Those factors have different influences on companies; the following analysis is based on the perspectives of SMEs and their responses.

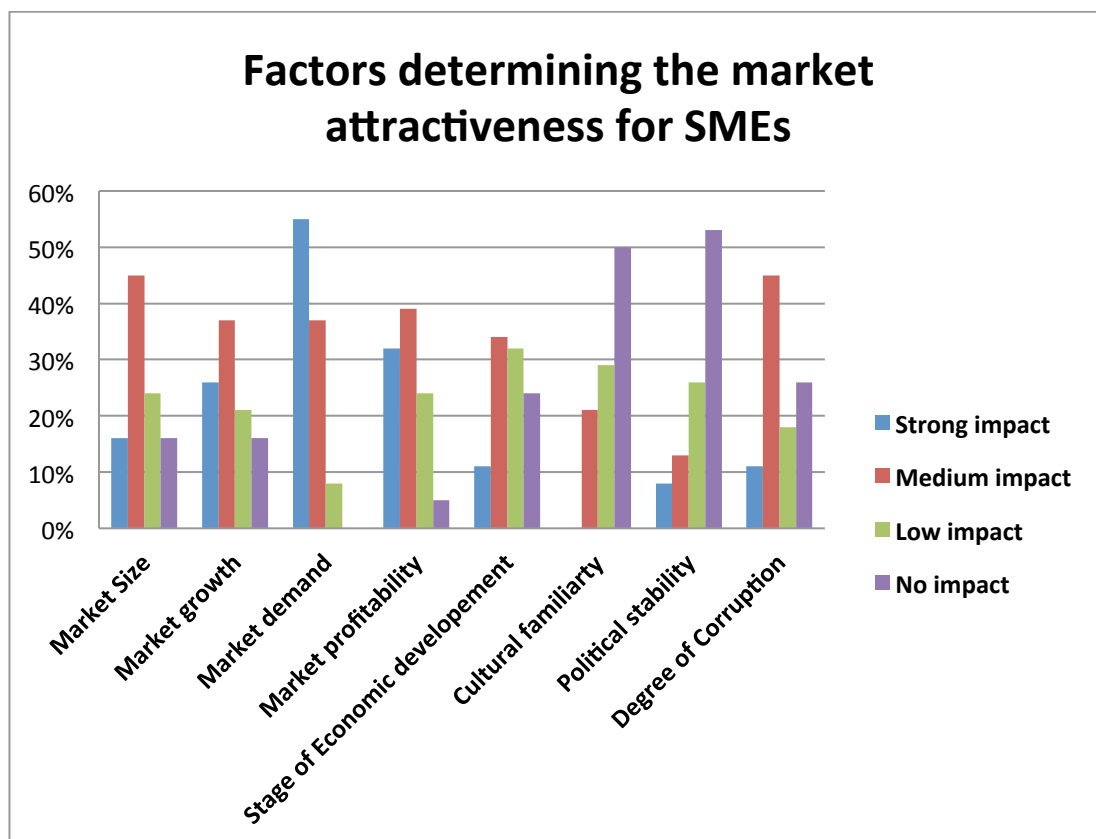


Figure 15. Market attractiveness

Market size can be determined in many ways like by researching the total GDP output or the total quantity of products which can be sold in the market. It is considered as a strong impact factor influencing the attractiveness of a market by 16% of the respondents. As shown in figure 15, 16% do not see a relation between the market size and the attractiveness of markets at all. Considering that altogether 84% of the companies see at least some influence related to this factor it has to be regarded as important for the overall attractiveness of the market. It is also interesting to see that 45% of the SMEs see a medium influence of this

variable, which means that those companies will definitely consider this factor when searching for target markets. The market size is important for companies because it shows how many products can be sold totally in those markets. When the market size is big enough even a small market share can already make up a large part of the revenue for a single company.

Market growth is also a factor which can be seen as important in figuring out if a market is attractive to enter or not. 26% of the SMEs see a strong impact of this variable. Another 58% see at least some impact arising out of this factor. Just a small group of 16% claimed that this factor does not have an impact on the attractiveness of a market. Market growth is important because the growth rate makes the future size of the market predictable, 20 years ago the Chinese market was relatively small compared to the US market, nowadays both are nearly equally big. This is based on the higher growth rates of the Chinese market compared to the relative low growth in the United States during the last two decades.

The biggest impact factor overall is market demand, it seems like that companies want to see that there is already some demand for their products in the market. Over half of the respondents think that the factor is very important in determining if a market is attractive or not. Additional to this 37% of the respondents think there is some mediocre impact resulting out of this factor when they do the evaluation of a market. Totally 100% of the respondents think that this factor has at least some influence on the target market attractiveness. Not a single respondent thinks that this factor is not influential at all.

Another factor which has to be considered is market profitability. It means how much profit can be generated by selling products to specific markets. Over 30% of the respondents think that this factor is of high importance. In opposite, just 5% think that there is no importance at all for the evaluation of the market. Keeping this in mind 20 times more people think that this factor influences them than vice versa. The market profitability is a key measure of selecting the target markets and its appearance. It is logical that companies think that entering profitable

markets is more useful than entering not profitable ones, but on the other hand, profitability might be overrun by other companies which see the same possibilities. If markets are too attractive it might cause rising competition. Therefore companies might not overestimate this factor because it can easily change over time. It might also be more interesting to predict profitability, because unprofitable markets can turn to very profitable ones. Still, the first mover advantage when entering unprofitable markets can generate advantages.

The stage of economic development indicates how advanced an economy is. Several measures like the gross domestic product per capita or the purchasing power per capita can be used to determine if an economy is developed or not. Depending on the products that companies sell, the stage of economic development can have different impacts. The overall results were mixed, because just 11% of the responding companies see a strong impact of this factor in evaluating the market attractiveness. Also more than 20% of the respondents do not see any impact resulting out of this factor. The respondents who assign at least some importance to it account for 76%. Even so, the measure is just the 4th most important variable when ranking the single factors against each other.

The cultural familiarity with the target market is not seen as important in general. Altogether 50% of the responding SMEs consider this factor as not important for their evaluation of a market. Even so another 50% think there is at least some impact resulting out of this variable in their decision which market they will enter. Not a single company regarded this factor as very important to their decision making. This variable is influenced by the geographical proximity, because 84% of the SMEs see the most promising markets inside of Europe. Considering this fact the distribution is reasonable because the cultural differences are relatively small in Europe. The attitudes towards work and life are similar and this might have some impact on the results as well.

Political stability is not seen as a factor which is influencing the target market attractiveness significantly. Just 8% of the SMEs regard this factor as important when they decide which market to enter. It is also seen as the least influential

factor because over 50% do not assign any importance to it. Over 45% of the respondents see at least some impact of this variable, even so the overall importance of this factor can be regarded as low. Among the researched factors it is the least important. Even so companies should consider it more carefully, because political stability is a main driver for economic prosperity. The distribution of the answers is based on the SME replies and therefore the European market clearly dominates the thinking when talking about the future target markets, in Europe political stability might be seen as granted but if the perspective changes to countries in Africa or Asia political stability should be regarded as more important.

Last but not least the degree of corruption in certain markets also influences the market attractiveness. More than 50% of the responding SMEs see a strong or mediocre impact of this factor when determining the attractiveness of a market. Even so the share of companies which do not regard corruption important for their target market selection is nearly 30%. It has to be mentioned that Germany has a low level of corruption and therefore company might project the absence of corruption to other countries. The problem is that corruption is much more common in many other countries than in the German domestic market.

Financing of the internationalization

Depending on the way of entering foreign markets the need for capital and therefore also financing is different. If companies venture abroad via exporting most likely this can be financed via the companies' own capital while more capital intensive entry modes might need a mixed financing or even a full financing of the foreign operations.

From figure 16 it became clear that SMEs tend to favor using their own capital for international expansion, nearly three quarters of the responding SMEs are financing their internationalization with their own capital. Just 24% use leveraging and an even smaller number use bonds. One reason for this might be that SMEs are not able to get proper financing from banks because due to their

size the amount of securities which banks require is limited. Even when bonds are used for financing, among SMEs they are not popular at all; just 2% of the respondents use them. This can be clearly related to the size of SMEs especially micro and smaller companies will not be able to use this technique because of the banking fees, the long planning period as well as the complexity of bonds can make this method of financing to demanding.

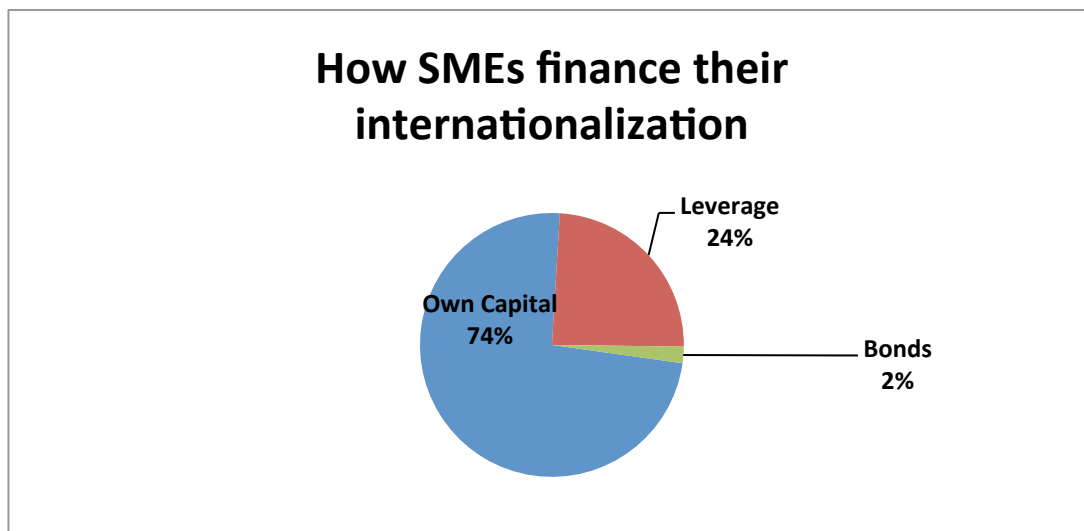


Figure 16. Financing of the internationalization

Not a single company used an IPO to finance their internationalization; even though IPOs are quite common in the Anglo-Saxon world in Germany there is a great fear of going public. During the early 2000s many SMEs went public to gain capital from the stock market, but later the Dot-Com bubble deflated and many companies lost trust in stock market related activities. Since those times the stock market seems to be too risky for smaller companies.

Influence of the internationalizing on the organizational structure

Organizational structure is an important issue when a company plans to international or if it is in the process of internationalization. Depending on the entry mode which was chosen a change in the organizational structure might be necessary. Therefore, it is important to know if companies adjust their structures or not.

As shown in figure 17, not even one third of the responding companies changed their organization while internationalizing. On the other side there are 71% which did not change their structure at all. Considering this ratio it seems like that changing the organizational structure is not needed or it simply is not adequate for the businesses. Also, higher costs can be a reason why the organizational structure is not changed even if it might bring advantages. Just 3% of the responding businesses changed their organizational structure more dramatically, not just by ramping up new departments. A quarter of the companies established new departments; even so it looks like staying with the current company structure definitely has advantages compared to the other possibilities.

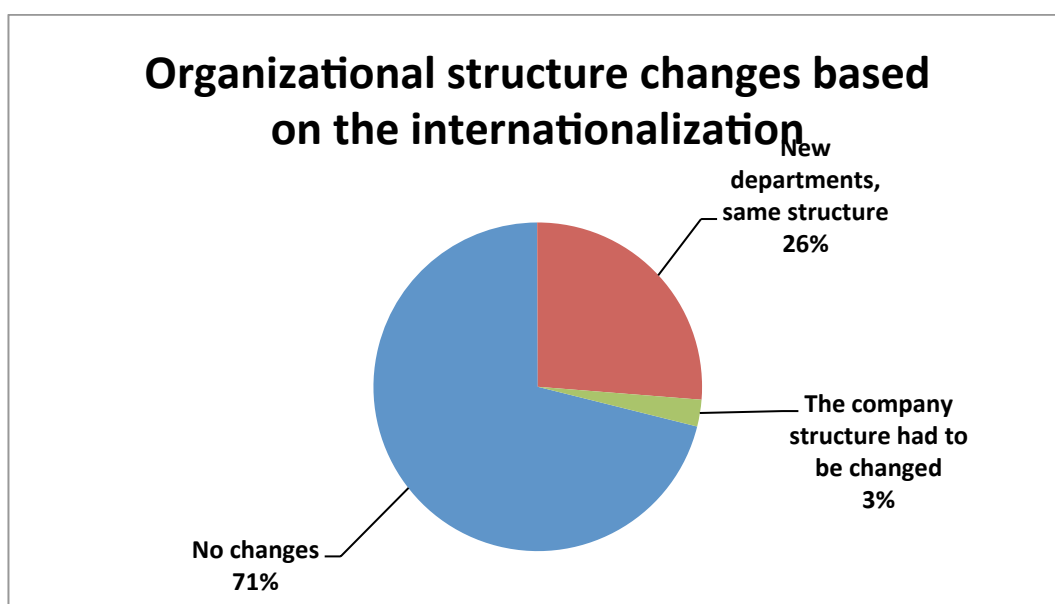


Figure 17. Organizational structure changes

One of the reasons for this outcome might be that the cost, not just financial costs but also opportunity costs are too high compared with the advantages a change in the organizational structure can offer. Another reason can be that the entry mode is not requiring a change at all, in case a company starts exporting it is not necessary to change the company structure because only foreign offers need to be processed and the delivery will be done by a carrier.

Internationalization impact

The question is generally about how companies in retro perspective evaluate the influence of the internationalization on their business.

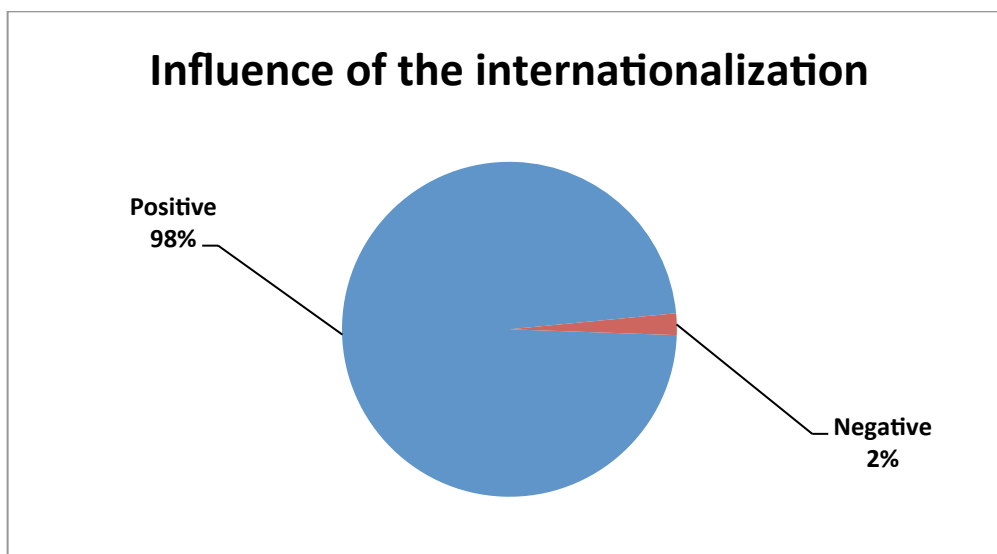


Figure 18. Impact of the internationalization

Figure 18 shows that the influence of the internationalization itself seems to be very positive for nearly all of the responding companies. Therefore, it can be said that they performed well in the international market; if not the number of negative answers would be higher. Even if the result was not expected to be so clear it just supports the importance of the thesis to micro and small enterprises which in general face the biggest problems with the internationalization process. Considering this, it has to be said that even though companies might face challenges prior and during the internationalization process the final results seem to be very promising. Just a very tiny share of 2% of the respondents evaluate the influence of the internationalization as negative.

3.2.4.3 Comments

During the analysis of the single aspects the need for further separation of the single variables based on the size emerged. The answers which were conducted have had to be split up to get an in-detail picture of the general situation. The

logic behind it was that the business size is heavily influencing the different aspects and how they have to be evaluated. Single questions have had to be merged together to determine single factors, without this the findings would not be valid at all.

It also has to be kept in mind that not every company is facing the same problems; one of the main findings was that medium sized enterprises do not have the same problems like micro and small sized business. Different aspects have to be evaluated differently concerning the companies size. The single factors like the company size influence, the demand analysis etc. turned out to be in line with the literature review which is supporting the main findings of this research.

Another finding is that SMEs heavily focus on a niche market strategy which can even give them an advantage over larger companies. It is important to see that there is a clear separation between larger companies and SMEs concerning their business strategies. Additional to this the study found out that international demand prospective is evaluated better than the demand prospective of the domestic market.

Those results are in line with the company goals of internationalization where the growth goals were the dominant factor, other reasons for international exposure were technological competence which is also related to the niche market strategy because it focus on generating a competitive advantage by fully focusing on a specific field where technological superior products can be offered.

SMEs seem to be very conservative in their financial planning, because the company's own capital was used to a much bigger extent for financing the internationalization than all other possibilities, including leveraging. This fact also is impacted by the choice of how to venture abroad. More than half of the responding companies chose export activities as their used way of internationalization. Most of the SMEs try to expand their business in Europe which bears less risk than moving further abroad. This is also indicating that SMEs follow a conservative internationalization approach. The geographical

proximity seems to be a main influential factor overall, because SMEs evaluate certain factors of the market attractiveness significantly differently than larger companies.

While SMEs try to establish operations in other European countries, larger companies have most likely already entered them. Therefore, larger companies have to find attractive markets further away. Even if a quarter still want to expand in Europe two third searches for new markets overseas in North America as well as in Asia.

The final questions concerning the retrospect perspective impression of the internationalization provided very positive results. It can be said that especially micro and small enterprises face challenges during the internationalization process. The overall results of companies which are already internationalized were nearly 100% positive, which indicates that the internationalization process has had a positive influence on their business. Therefore, this guidebook of how to internationalize SMEs seems to be perfectly fitting to the challenges they have to face and how to overcome them!

3.3 Qualitative study

The qualitative study is based on interviews which were conducted among two SMEs and a multi national enterprise (MNE). Those interviews aim at getting in-depth knowledge about how to solve the problems related to the nature of SMEs, because especially micro and small enterprises face challenges related to their size. The MNE will provide information about how to solve those problems.

3.3.1 Research method

The qualitative study is based on interviews, a common qualitative research method. Qualitative methods are offering several advantages, therefore interviews will be done in accordance to “produce findings not arrived at by statistical procedures”. (Gill & Johnson 2010, 148) Interviews are based on interaction between the researcher and the respondent; it enables a deeper insight to the

different subcategories of the theoretical framework by letting the participants interactively describe their thinking.

The qualitative research has to be seen as complementary to the quantitative research which was conducted earlier. It is an essential part of solving the research problem. Interviews will be conducted to gain in detail knowledge about the factors concerning SMEs in and during the internationalization process. Those interviews are just bound to the overall research problem, enabling a maximum of flexibility. It will be possible to adjust the interview process during the actual conversation to track down problems related to the internationalization of SMEs. The focus lies on the interviewees' point of view, how they evaluate the current situation of their company as well as general factors concerning the research problem. Due to the great flexibility of this research method it possible to understand the restraints, the problems as well as the opportunities SMEs see in the internationalization of their businesses.

The qualitative research in this case follows a two stage approach, first the problems related to the internationalization process of SMEs will be discussed with interviewees working in small and medium sized enterprises while the second part is based on finding solution from a different perspective, therefore a single interview will be conducted with a company which can already be regarded as a full-fledged multinational enterprise. A combination of both can provide useful and down to earth knowledge which can help SMEs to overcome obstacles of internationalization process.

3.3.2 The interviewees

The interviewee participants can be separated into two distinguished groups. The first group is about SMEs, in those interviews the target will be on identifying the challenges of small and medium sized enterprises, as well as their subjective impressions related to them. The counterpart is a larger, already internationalized company which will enable a deeper understanding of how to overcome those obstacles.



Figure 19. Interviewed companies.

The combination of different aspects described and analyzed from several perspectives, will enable a deeper understanding of the challenges of the internationalization as well as the possibilities to overcome them in a successful way. The selected participants stand representative for the different types of companies and their degree of internationalization.

3.3.3 Analysis of the interview results

All interviewees agree upon that the first step is the most important and also the most challenging one in the internationalization process. Many factors were mentioned by the interviewees; those issues have to be regarded as big threats when talking about the internationalization of small and medium sized enterprises.

3.3.3.1 SME interviewees

First of all it seems to be important that contacts are established in advance, because it would take some risk out of the internationalization process, especially the second interviewee regard contacts as the most important factor overall. It was mentioned that contacts, also called connections, not just bring security in a financial way, also new business opportunities can be opened via them. On the

other hand, it is seen hard to establish those contacts to foreign companies out of the domestic market. Therefore, business travels as well as trade shows were mentioned as a way of getting in touch with companies from other countries, especially when the company wants to expand in a faster way without waiting for unsolicited foreign offers those ways of establishing first contacts should be used. Internationalization can also be customer driven, if the customers go abroad the supplier companies have to follow to be competitive compared to other suppliers, in this case the contact is actually the purchasing company which might offer help.

Another factor which was seen as a critical factor is to receive the money; especially in international business it seems to be hard to evaluate the financial standing of a specific company. One of the interviewees also mentioned that a foreign customer once went bankrupt and was not able to pay the bills; then international law also caused problems. The result of it was that the company has had to write off the whole order and this caused financial losses. Considering this it is logical that the interviewee regards it hard to trust companies anymore and involves banks to secure payments. Risk in general is one of the big obstacles of internationalization; especially reducing the financial risk might not be easy for SMEs because they lack the knowledge of the different tools which can be used. One of the main findings was that the ways of securing the payment were not known or just to a small extent.

It has already become clear that SMEs favor their own capital over leveraging the financing of the internationalization process, this might lead to the wrong conclusion that SMEs do not really prefer to use their own capital, they simply lack the financial assets which can be used as securities. Both interviewees agree that the lack of financial assets which would have been necessary for obtaining credit were not existent at the early stage of internationalization. Therefore, leveraging the company by using credits is a double edged sword, as it is just a possibility for businesses with a larger amount of assets which can be used as

securities for the banks. Even so the lack of leveraging is not especially seen as a threat for the internationalization but as a factor which slows it down.

Another factor which influences or has influenced the interviewees' internationalization is the lack of knowledge. This aspect is broader than it might seem at the beginning. There are challenges in getting information about the demand in specific markets. It is hard to get in-depth knowledge without being in the market itself. One of the interviewees already internationalized the business and obtained the knowledge by actually doing business in the market and via this way the needed information was collected. Especially when doing market research, problems like the lack of reliable data and the absence of data at all have to be faced. The best way of obtaining reliable data seems to be actually doing field research, contacting companies which might be future customers and research the demand via this way. Another way which was mentioned is relying on desk research but this is seen as not reliable because for some countries not even the national statistical office is regarded as trustworthy enough to base business decisions on.

Related to the lack of knowledge of the market demand the pricing strategy in the foreign market is challenging. The SMEs do not know how much they can charge for their products in a foreign market. The only method which was mentioned by both interviewees was the competitive pricing, premium pricing in this way was not an issue because both think that when entering a market the first priority should be to gain customers first. Later on the pricing strategy could be changed to push up the margin if the market demand leaves the impression that it is possible to do so.

Another sub factor of the lack of knowledge is about the actual internationalization process, the micro sized company answered that for their size it is nearly impossible to get enough knowledge to evaluate the company's specific advantages and disadvantages arising out of a possible internationalization. It seems hard to access such data, even in Germany where the

regional Chambers of Commerce offer services related to the internationalization of SMEs the knowledge factor is an obstacle.

Both interviewees see a burden in internationalization in terms of paper work, the first interviewee regard the regulative barriers as an important factor in the choice of the target market, because when trading with countries outside of the Schengen area much more bureaucratic problems will occur. The interviewee of the already internationalized company mentions that in their business field even inside of the Schengen area many country specific regulations are challenging them and take time which would be better used for actually trying to acquire more customers. The interviewee of the micro sized company even goes so far to claim that the bureaucracy and regulations of certain countries might make it impossible to do business at all.

The interviewees both mentioned that the market opportunities in terms of significantly higher revenues are promising for them. The already internationalized company has expanded to several countries enabling them to generate much higher revenues compared to if they just would have focused on the German market. They used internationalization to balance their revenue streams and to maintain the price level, in the last decades the prices for their products decreased in Germany due to a mature market while in other European countries they were able to sell their products in times of low domestic demand at higher prices. Therefore, the interviewee agrees that internationalization drove their revenue growth; also the profit margins increased because they were able to sell their products to markets where the competition is less intensive than in their domestic market. FROM HERE

Another internationalization benefit for this company is that they can sell their products to a wider range of customers; therefore they were able to maintain the profit margins while in Germany many similar companies faced hard times and even went bankrupt. During the market adjustments in the 1990s where an overproduction of the traded goods challenged many companies the foreign markets were a key asset and helped them to survive the market consolidation.

3.3.3.2 MNE interview

The third interview was done with a larger multinational company which already has several subsidiaries abroad. The interview gives information of how to tackle problems which SMEs face during the internationalization process, therefore specific questions regarding the challenges they have faced and how they have overcome them were discussed.

First of all the internationalization process of the company differed quite significantly from other businesses, because the company used their clients to internationalize their operations. Due to previous domestic products they already established a deep relationship and when the customer wanted to internationalize they went with them to foreign markets. Therefore they were pulled abroad by their key clients.

One of the key challenges of the company during the internationalization process was that the cultural differences between the domestic market and the foreign target markets were quite significant; this is based on the fact that most of the projects were realized outside of Europe. To face this problem a step-by-step approach was used, first the company went with their clients to foreign countries where they were able to get to know the working environment. The clients supported them during this process and offered help. After this stage was finished, foreign subsidiaries were established to provide customer support. When entering new markets the company always has had the advantage of being already backed up with contracts and the legal safety resulting out of them. Due to the international exposure they were able to adapt step-by-step to the local business culture which varied significantly from the German culture in terms of habits and especially language.

Another factor which influenced the internationalization process of this specific company was national regulations of the target markets, which have had to be dealt with during the project planning and establishment stages. Because no preoccupied knowledge inside of the company was available, the company tried to

gain experience first by themselves, but also external knowledge was used by hiring specialist related to different fields. This is regarded as a key for being successful in foreign markets, a combination of self-gained knowledge as well as external knowledge, because the interviewee clearly states that in detail information about country specific issues is hard to acquire without local experts.

The company reduced the risk by picking high solvency customers as their key clients for venturing abroad, this is important because SMEs see a big problem in the financial losses which might occur if the customers are not paying their bills or not fulfilling their legal obligations. Therefore the customer selection has to be seen as a top priority for SMEs to reduce their risk exposure. Also, the contractual layout was mentioned when talking about risk reduction of the internationalization, because contractual terms can limit the risk and especially partial payments in advance and during the fulfillment can level the cash flows to a steady stream. The payment terms can reduce the risk as well as the need for leveraging; due to this the company never obtained credits for financing their foreign projects.

The interviewee also states that banks are not used often to protect the financial situation of the company. The business heavily relies on the creditability and solvency of its customers to reduce the financial costs, like bank fees, which are not direct related to the projects itself. Additional to this the interviewee explained that in general it is more advantageous to focus on larger customers because their possibility for delayed payments or defaults is much lower than of smaller companies. Additional to this the administrating costs can be apportioned in a better way to the single projects. Therefore it can be said the bigger deals offer higher security, relatively lower administration costs as well as the possibility to get further offers when the first projects go well.

Establishing contacts in advance or during the internationalization can also provide advantages, because contacts can be used as middlemen to get to know the business environment and it is also possible to acquire new customers to some extent. Business relations in general are a main asset when dealing with foreign

countries, because those relations are door openers. Not just companies which want to sell their products abroad face risk, but also companies in the foreign markets which buy those products. In this case a business relation can establish mutual trust and recommendations can finally make the deal happen. Extended networks of business relations therefore have to be seen as a main asset of every company dealing with internationalization. It might take time but those relations can already be established while just operating in the domestic market.

3.3.3.3 Comments

The interviewees were able to provide a multifaceted picture of the internationalization process. Many problems and how to tackle them were discussed. It is important to see that there is not a specific problem which bothers SMEs specifically; it is a combination of several problems which makes it hard for them to internationalize.

In the previous section it was mentioned that contacts to foreign countries can reduce the risk in several ways. First of all they provide security, because if the contacts are trusted partners they can enable the company to get knowledge from them which can be used in the internationalization process. Additional to this the contacts gives security because they can establish first contacts with other companies, they can also be used as middlemen to generate mutual trust among both parties. All of those factors should be considered, and therefore contacts to foreign countries should be seen as an asset. SMEs are not aware of this and maybe should consider hiring people from the country where they want to expand to before the actual internationalization process. This way the company uses the private as well as the business networks of those people to their benefit.

Another factor is financing, even when SMEs most likely finance their internationalization by using their own capital it should be considered to use leveraging or other financing methods to a larger extent. The lack of capital cannot just be solved by using credits, also bonds and IPOs can be used, even though both methods are not popular they might solve this problem more

effectively and faster than just relying on company's own capital or the bank loans. Especially leveraging via bank loans is seen as a critical factor; because SMEs generally do not have enough assets which can be used as securities, banks might not be willing to give loans and this can lead to a delay where opportunities are wasted. Therefore more ways of financing should be considered. It also has to be seen that knowledge has a big impact on the internationalization of SMEs. The lack or the total absence of knowledge about how to internationalize a business is seen as critical factor. Companies have to know what they should do and when they should do certain steps of the internationalization process. It is important to see that one of the interviewees did not know how to start, even if the company would want to go international. Knowledge is a critical factor and it can be obtained in several ways, as shown in figure 20. First, knowledge can be gathered internally by attending seminars which are focused on SMEs or by doing desk research about how other companies internationalized. On the other hand, a step-by-step approach can be followed; this means that a company tries on itself to perform the internationalization without prior knowledge.

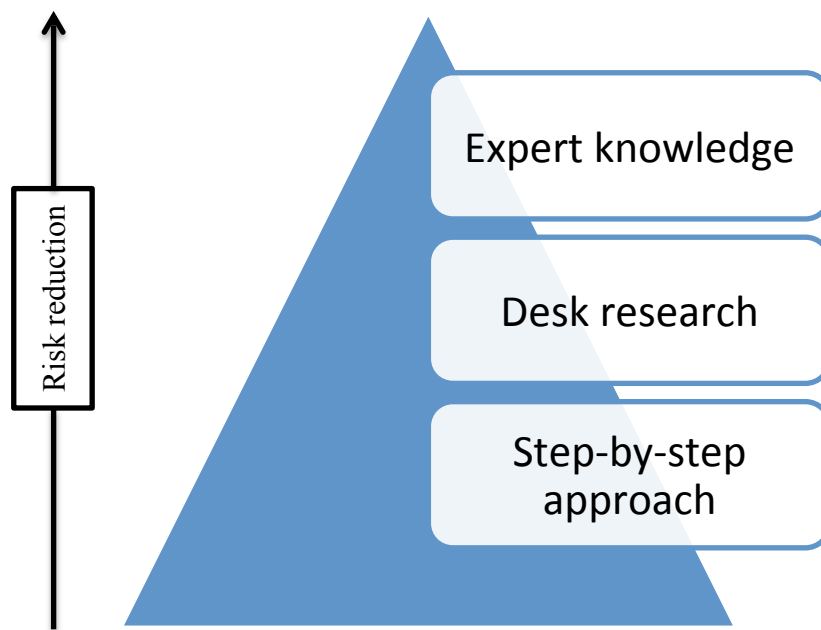


Figure 20. Ways of obtaining knowledge about foreign markets

The second way of obtaining knowledge is to “purchase” it; this can be done by hiring experts or people who already know how to internationalize businesses. This might be more expensive in the beginning but the knowledge can speed up the process and reduce the risks significantly.

4 CONCLUSION, SUGGESTIONS AND A NEW THEORY

The 7th and 8th chapter of this study dealt with the quantitative as well the qualitative analyses of the research which gave in detail information about the problems SMEs face during the internationalization process; this was complemented with different ways of challenging those problems. In chapter 9 the findings will be combined to provide a conclusion to this topic. In addition to this a new internationalization theory will be discussed and last suggestions related to further studies will be given.

4.1 Proof of validity and reliability

Every research has to be valid and reliable, otherwise the results will be not be able to be used by other researches and it might be that the research is not replicable or even if it is it might not bring the same results.

The research, which was conducted, was split into two parts, a qualitative as well as a quantitative study, therefore both have to be evaluated separately. One factor which contributes to the reliability of the quantitative study is the absence of participant error due to the high degree of standardization. The research was done via an online survey the participants were not influenced by the researcher. Another factor contributing to a high reliability is the pretesting, which was done prior to the actual research, because all unclear formulations were eliminated. Another factor contributing to a high reliability of the quantitative research are the measures taken to reduce the participant bias. The survey did not include leading questions or questions where the answers were already predetermined, the cover letter of the research clearly stated that this research is anonymous and just unpersonalized information will be used for the analysis part of the study. The qualitative research is reliable because it is based on interviews conducted among companies which can be seen as representative for the SME spectrum. The problem of qualitative researches is that the reliability just can be proven by other researches which use the same data and come to the same conclusions. Even taking this into consideration it is possible to say that the research is reliable

because the MNE company was asked about its initial problems and the answers which were given are strongly correlating to the problems SMEs face during their early stages of internationalization. Another factor which contributes to a high reliability is the fact that the qualitative study was conducted via online interviews, therefore the researcher did not influence the participants. Another factor is that the research was very well documented providing deeper insight into the research process to other researches which finally can prove the research as reliable.

The validity of the research also have to be analyzed from two perspectives, the validity of the quantitative study is mainly based on the pretest which was done, it eliminated all kind of errors related with the drafting process. Additional to this feedback was a key factor to achieve a version with uniform understanding. Also expert expertise helped to achieve a high validity of the quantitative study, due to the theoretical background knowledge how to draft a survey in a proper manner it was able to avoid validity reducing faults. When it comes to the validity of the qualitative study it has to be said that it is hard to evaluate because the interpretation, even the researcher tries to be objective always will have a subjective interpretation to some extend. The human influence can not be fully eliminated. During this research the documentation played a major role in establishing validity, because due to detailed documentation it is possible to reduce the human influence. The interpretation of the interviews was based on notes which were taken during the whole interview process, the interviews were also recorded to rethink the interpretation after some time because the subjective influence normally decreases over time. The interpretation was done via the notes taken during the interviews.

Altogether the research can be regarded as reliable and valid, even so it has to be said that reliability for the qualitative research just can be finally proven by other researchers which go through the research.

4.2 Essential aspects of the research

During this research various aspects have been discussed, including problems which SMEs face during their internationalization process as well as how to solve these problems. The empirical research clarified the areas which are essential for internationalization process of SMEs. It also showed that SMEs are not a uniform group of companies and a differentiation between micro, small and medium sized enterprises was necessary to research the single problems in more detail.

During the research this separation provided findings which were not expected. Even though the research follows a general approach; because it should be applicable for all SMEs, it showed that companies, especially micro and small enterprises, face different problems than medium sized business. Internationalization includes various parts of the business life, reaching from entry modes over financing to cultural issues; this is the reason why just the main problems were dealt with during this research.

In general the research found out that the medium sized enterprises are already highly internationalized while the micro and small sized businesses face many challenges which prevent them from venturing abroad. Medium sized enterprises are already in a stage where their size seems to have no influence to their decision making anymore while it is biggest restraint of micro and small companies. Considering this fact a separation between them is necessary. Especially the overall satisfaction of already internationalized companies is very interesting to analyze, because the overall satisfaction with the internationalization is extremely high among all company sizes.

Another interesting finding is that the companies do not regret going abroad, but the challenges for micro and small enterprises at the beginning look too big to overcome. The two interviewees who were working in already internationalized companies gave a good impression of why smaller companies think so. The aim of this research was to build a guidebook for SMEs, after the research it emerged that not SMEs in general need support for their internationalization process but

micro and small business. It is important to consider that companies with a smaller size face significantly higher obstacles which have to be overcome in order to internationalize the business.

It also has to be said that many factors in regard to internationalization turned out to be not very important or not important at all. Especially the cultural factor is hard to evaluate because in the quantitative research not too many companies regarded it as important while, on the other hand an interviewee from a MNE sees this factor as one of the main challenges in internationalization. A reasonable explanation can be constructed but not proven, even as the research was very successful considering the fact that over 75 companies participated and shared their experience. A combination of quantitative as well as qualitative research enables getting results which were quantifiable as well as deep enough to gain a full picture on what concerns SMEs during their internationalization.

4.3 Internationalization paradox

In this subchapter a theory will be explained which focuses on the relation between the size of a company, the challenges of internationalization and the degree of internationalization. During the result analysis of the quantitative research a pattern concerning the degree of internationalization depending on the size of the company was discovered. It is based on the fact that micro and small enterprises significantly lack behind medium companies as well as larger businesses in terms of internationalization.

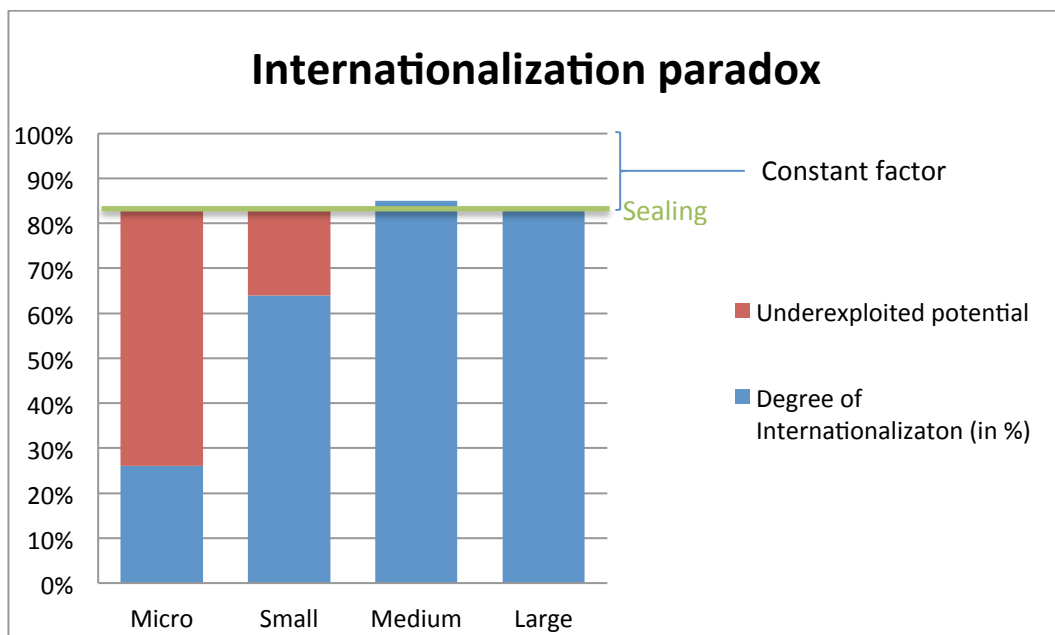


Figure 21. Internationalization paradox

The constant factor can be determined by taking a look at the internationalization percentage of large companies, considering that there were just two companies mentioning reasons for the absence of international operations it was important to analyze them, both were not interested in internationalization. Therefore, it can be reasoned that those companies do not want to internationalize because the foreign markets are not attractive for them at all. When this reasoning is correct it can be concluded that they skip internationalization for some domestic market reasons, otherwise they would internationalize as well. Considering this fact there is a maximum percentage of companies which see benefits arising out of the internationalization and therefore will internationalize someday.

When there is a constant factor determining how many percentage of the overall population will internationalize the difference to the current levels of the subgroups micro and small companies have to show an underexploitation of the internationalization possibilities. This underexploitation of the internationalization than have to be based on the problems those companies face. Those problems were analyzed in the quantitative as well as in the qualitative part of this thesis.

The constant factor can be influenced by various factors, because companies have to evaluate if the domestic market is attractive enough to drop the internationalization of the business. Considering this the companies which are included in the constant factor are not willing to internationalize for some reasons. The constant is based on the attractiveness of the domestic market compared to foreign markets. The attractiveness of the domestic market have to bind them to the local market, therefore the constant should be determined by the same reasons as why companies venture abroad which just have to be applied to the domestic market. Key variables for the market attractiveness were described in the theoretical part of this thesis and are applicable for this constant factor.

It might be surprising but the logic behind this constant factor is that there are companies which do have all possibilities to internationalize but even so they do not venture abroad. The influences of the single variables like market attractiveness, management decisions are not researched yet. Additional to this the theory has to be proven by other researchers to compare the findings and finally create a theory based on more than one sample.

4.4 Suggestions for further research

The theory which developed in this thesis is new; therefore no other research results are available. Considering this it is advisable to get deeper into factors which are influencing the constant factor of the internationalization paradox theory. Especially the impact of the single variables might be interesting, because if the market attractiveness is really influencing this constant factor like the previous section described it, than every single country in this world would have a different constant factor. Country comparisons will be possible to determine if companies in specific markets face a broad underexploitation of their internationalization potential and their reasons for it. Additional to this it might also be interesting to know how what happens if this variable changes, consider China where the constant should be very high at the moment because several international researchers came to the conclusion that the Chinese market is very attractive at the moment. This factor will enable the researchers to determine how

harsh the international competition will be in the future. In case that the GDP growth in China slows down significantly the constant shrinks and western companies should increasingly face competition from Chinese companies on the international market.

4.5 Summary of the Thesis

The aim of the thesis was to provide a general applicable framework for the internationalization process; it should provide information as well as describe different factors influencing the internationalization process.

Therefore the theoretical study was designed to cover all the aspects which influence the internationalization process, it included a wide area of aspects like how to analyze markets, the culture of those markets as well as political issues. Another aspect which was dealt with was the entry mode selection to determine which fits best to a specific company. The financing of the internationalization was also explained in detail, in retrospect the choice of the described tools seems to fit quite well, because SMEs generally do lack general as well as specific information concerning the internationalization process.

The empirical section the research was conducted via a quantitative research as well as a qualitative research. The combination of both was necessary for getting a full picture of the internationalization process. If just one research method would have been used the results would not have been as focused and detailed as they are now.

In the conclusion a new theory was described, the relationship between size of a company, the challenges of internationalization and the degree of internationalization was never researched before. The constant factor has the potential to be applied in many different ways, especially it clearly shows how underexploited the potential of internationalization among micro and small enterprises are

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APPENDICES

Appendix 1.

Questionnaire in English

General Information

1. How many employees does your company have?

- | | |
|------------|------------------|
| 1. 1 - 10 | 3. 51 - 250 |
| 2. 11 - 50 | 4. more than 250 |

2. What is the annual revenue of your company?

1. under 2.000.000€
2. between 2.000.000€ and 10.000.000€
3. from 10.000.000€ to 50.000.000€
4. more than 50.000.000€

3. What competitive strategy describes your company best?

1. Cost Leader strategy (characterized by high volumes and low prices)
2. Differentiation strategy (characterized by unique products and premium prices)
3. Niche market strategy (characterized by small volumes and high prices)

4. How long does your company already exist? _____

5. Which sector generates most of your revenue?

1. Service
2. Manufacturing

6. How do you think the sectorial economy is developing on an International level?

1. Increase sharply
2. Increase
3. Stagnate
4. Decrease
5. Decrease sharply

7. How do you think the domestic sectorial economy will develop?

1. Increase sharply
2. Increase
3. Stagnate
4. Decrease
5. Decrease sharply

Detail Information

8. Why is your company not operating abroad? (You can select more than one option)

1. No interest in international business
2. Lack of resources (financing, human resource)
3. Lack of knowledge
4. Too much risk
5. Cultural differences are too big
6. Top level management restraints

9. Did your company already internationalize in any way? (Exporting etc.)

1. Yes
2. No
3. No, but planned

If “No” in Question 9, thank you very much for your information and the time you spend on filling in this survey.

10. How do you think your company performed during the internationalization until now?

1. very good
2. good
3. neutral
4. bad
5. very bad

11. Which entry mode did your company use for internationalization? (You can select more than one option)

- | | |
|----------------|---------------------------|
| 1. Exporting | 4. Joint Ventures |
| 2. Licensing | 5. Greenfield Investments |
| 3. Franchising | 6. Acquisition |

12. Evaluate the importance of the following factors for your company's internationalization.

4 - strong influence 3 - mediocre influence 2 - low influence 1 - no influence

- | | | | | |
|--|---|---|---|---|
| 1. Profit and growth goals | 4 | 3 | 2 | 1 |
| 2. Technological competence | 4 | 3 | 2 | 1 |
| 3. Managerial urge | 4 | 3 | 2 | 1 |
| 4. Foreign market opportunities | 4 | 3 | 2 | 1 |
| 5. Economies of scale | 4 | 3 | 2 | 1 |
| 6. Tax benefits | 4 | 3 | 2 | 1 |
| 7. Unsolicited foreign orders | 4 | 3 | 2 | 1 |
| 8. Competitive pressure | 4 | 3 | 2 | 1 |
| 9. Small or saturated domestic market | 4 | 3 | 2 | 1 |
| 10. Overproduction / Overcapacity | 4 | 3 | 2 | 1 |
| 11. Proximity of international customers | 4 | 3 | 2 | 1 |

13. Which geographical market is the most promising from your companies' point of view?

- | | |
|-------------------|------------------|
| 1. Europe | 4. North America |
| 2. Eastern Europe | 5. South America |
| 3. Asia | 6. Oceania |

14. Evaluate the following factors depending on their importance to your choice of the target market.

4 - strong influence 3 - mediocre influence 2 - low influence 1 - no influence

1. Market size	4	3	2	1
2. Market growth	4	3	2	1
3. Market demand	4	3	2	1
4. Market profitability	4	3	2	1
5. Stage of Economic development	4	3	2	1
6. Cultural familiarity	4	3	2	1
7. Political stability	4	3	2	1
8. Degree of Corruption	4	3	2	1

15. How did your company finance the internationalization process? (You can select more than one option)

- | | |
|-------------------|----------|
| 1. Leveraging | 3. Bonds |
| 2. Equity Capital | 4. IPO |

16. How was the organizational structure of your company affected by the internationalization process?

1. No changes
2. New departments, same structure
3. The company structure had to be changed

17. Did the internationalization have positive influence on the development of the company?

1. Yes
2. No
3. Mixed results