

NELLY DASZKIEWICZ
KRZYSZTOF WACH

INTERNATIONALIZATION OF SMEs

CONTEXT, MODELS AND IMPLEMENTATION



Gdańsk University of Technology PUBLISHERS

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Introduction

During the last three decades SMEs have been very important players in national economies. They are dynamic and flexible and their role in job creation is crucial. Moreover, due to internationalization of economies and accelerating globalization processes a decade ago, a growing number of SMEs have been trying to take advantage of new environmental conditions, i.e. appearing chances for internationalization. Thus, many of them have started entering new markets.

It should be stressed that internationalization of firms – as a research topic – until 1970s concerned large enterprises rather than SMEs. It was due to the fact that most of small firms not only functioned locally, but what is more, were not interested in going international at that time. However, international behaviours of SMEs as well as researchers' attitudes towards internationalization have changed over time. Initially, internationalization was viewed as an export-led phenomenon and an incremental process. Later, new approaches were developed.

The purpose of this book is to present internationalization of SMEs in a broad sense; its contexts, models and ways of implementation. The book tries to combine two perspectives – the academic theory and the business practice. From the theoretical point of view, the book covers a long research period – since the early 1970s (e.g. stages models) up till now (e.g. holistic and integrative approaches or knowledge-based models). From the pragmatic point of view, the book shows the steps needed to prepare and implement the successful international strategies, especially in the European context.

On one hand, the book can be considered as interesting to academic scholars as well as PhD students exploring the present-day concepts of internationalization of SMEs. On the other hand, the book is addressed to economics and business bachelor and master students as a supplementary textbook. It may also be of interest to entrepreneurs as well as managers, who are considering or are just interested in going international. The book offers to them the knowledge they require as well as useful tips.

The book consists of six chapters, the first two of which try to combine the theory with the practice, while the last four have more theoretical character.

Chapter 1, *Context of Contemporary Internationalization Processes of SMEs*, has introductory character. At first, the key terms (internationalization, globalization, Europeanization) and their contexts are explained. It also presents the role of SMEs in contemporary European economy according to statistical data and research results. Finally, the influence of these processes on SMEs are described.

Chapter 2, *European Context of Internationalization*, shows the conditions for internationalization European businesses within the European Union. The EU law in the field of doing cross-border business (including the EU freedom of establishment and the legal forms of businesses) was discussed. Finally, the formal and economic conditions for doing business in the EU in the international comparative perspective, were discussed.

Chapter 3, *Internationalization Strategies for SMEs*, elaborates on the implementation of internationalization strategies, their preparation and structures. It presents modes of internationalization in three groups, which are sales internationalization (e.g. indirect, direct, cooperative export, representative offices), contractual forms based on the international cooperation (e.g. licensing, franchising, strategic alliances), foreign direct investments (e.g. branches, joint-venture and wholly-owned subsidiaries). The role and importance of ownership structure for greenfield and brownfield international business was also discussed.

Chapter 4, *Classical Approaches towards Small Firm Internationalization*, presents “old” internationalization theories. In spite of fast development of the research and new approaches towards small firm internationalization, most of the described theories are still very strong and significant paradigms. Stages theory, ‘eclectic paradigm’ (OLI), resource-based models, ‘born global’ SMEs may be examples of the classical approach. Moreover, models for transformed economies are presented.

Chapter 5, *Internationalization of SMEs through Networks*, concerns the role of network in small firm internationalization process. This approach concentrates on the market and the relationship of the firm to that market. According to the network approach internationalization is seen as a process in which relationships are continuously established and developed, with the aim of achieving objectives of the firm. The impact of network relationship on SMEs internationalization process is also described.

Chapter 6, *New Approach towards Internationalization of SMEs*, shows the attempts to integrate different approaches towards internationalization. There is no doubt that nowadays internationalization is a complex phenomenon. Therefore, researchers have been looking for new conceptual frameworks. Holistic approach, integrative model and knowledge-based models are described.

Nelly Daszkiewicz
Krzysztof Wach

Context of Contemporary Internationalization Processes of SMEs

1.1. Internationalization and Its Context

Internationalization itself as well as associated processes which contribute to its context may have different faces, dimensions, horizons, perspectives and levels. Thus, it would be not only pointless, but even impossible to give universal definitions of the ongoing processes. First of all such ongoing processes like globalization, regionalization, universalization, internationalization, transnationalization, Europeanization, or integration should be always taken into consideration from a given point of view. For example their meanings differ in economics, management or political sciences. What is more, they may and they do differ even within economics as a scientific discipline. The level of analysis within a scientific field is also very important. Most authors distinguish these processes on three levels, that is macro (economy), meso (industry) and micro (firm)¹⁾. Such a delimitation is essential to adopt an appropriate definition in a given research area (e.g. in relation to the economy for macroeconomics and in relation to a company for management science or microeconomics). Even taking the levels into consideration, it is necessary to be aware that there is no generally accepted definition of internationalization or globalization, nor Europeanization.

Internationalization

The internationalization of the economy is as old as international trade dating back to ancient times, from the earliest civilizations, however the beginning of the systematic cross-border trading was marked in Europe in the Middle Ages (the Hanseatic League would be a good example). Zweig defined²⁾ internationalization as “the expanded flow of goods, services, and people cross state boundaries, thereby increasing the share of transnational exchange relative to domestic ones, along with a decline in the level of regulation affecting those flows”³⁾. The Group of Lisbon combined the internationalization of economy and

¹⁾ Ritzer G.: *Introduction to Part I* [in:] *The Blackwell Companion to Globalization*, ed. G. Ritzer, Blackwell Publishing, Oxford – Carlton 2007, p. 17; Ladi S., *Globalisation, Policy Transfer and Policy Research Institutes*, Edward Elgar Publishing, Cheltenham – Northampton 2005, p. 16.

²⁾ Zweig D.: *Internationalizing China: Domestic Interests and Global Linkages*, Cornell University Press, New York 2002, p. 3.

³⁾ A similar definition is given by Milner and Keohane, who see internationalization as „a process that can be empirically measured by the growth in the proportion of international economic flows relative to domestic ones”. Milner H.V., Keohane R.O., *Internationalization and Domestic Politics*:

society altogether and defined it as referring “to the flow of raw materials, semifinished and finished products and services, money, ideas, and people between two or more nation-states”⁴⁾. Similarly, Smallbone underlined that the internationalization makes up of the variety of processes including internationalization of markets, internationalization of production, internationalization of capital, internationalization of labour and internationalization of regulation⁵⁾.

Welch and Luostarinen defined the internationalization as „the process of increasing involvement in international operations”, which can be treated both at the level of particular national economies as well as particular companies⁶⁾. Similarly, Rymarczyk⁷⁾ and Pierścionek⁸⁾ defined the internationalization as any economic activities undertaken by a company abroad.

While discussing the internationalization process, it is necessary to distinguish it from multinationalization (or transnationalization, which some authors consider as a synonym), which is characterized “fundamentally by the transfer of relocalization of resources, especially capital and to a lesser extent labour – from one national economy to another”⁹⁾. In this context the multinationalization is a narrower term than the internationalization coin as it is reached mostly by direct subsidiaries, acquisitions and various types of cooperation, while internationalization includes any single kind of international activities. Multinationalization is also considered as multiterritorialization, especially in a sociological point of view.

Globalization

Globalization in comparison to internationalization is much more younger as a concept and coin. It became popular as a scholar theme in 1990s. At the macroeconomic level, the globalization is treated as the phenomenon of increasing globally diverse ties between the economies, following the increasing size and increasing the diversity of transactions of goods, services and international financial flows as well as technology transfers as a result. International economic interdependence, which is repetitive and one of the essential features of the global economy in the early 21st century is one of the key existing definitions of globalization. Permanent relations and reliance on economies of individual countries and regions constitute a system of global economy, which can be defined as interdependent economic relations between the economies of individual countries, occurring primarily in the sphere of international trade, international financial transactions and the development of world economy. Globalization as the process has many faces and occurs in many ways. Ruigrok and van Tulder distinguish seven basic dimensions of globalization in the world economy (table 1.1). constituting framework for the activities of enterprises, especially in the process of their internationalization.

An Introduction [in:] *Internationalization and Domestic Politics*, ed. R.O. Keohane, H.V. Milner, Cambridge University Press, Cambridge 1996, p. 4.

⁴⁾ The Group of Lisbon, *Limits to Competition*, PIT Press, Cambridge – London 1995, p. 15.

⁵⁾ Daszkiewicz N.: *Internacjonalizacja małych i średnich przedsiębiorstw we współczesnej gospodarce*, SPG, Gdańsk 2004, p. 15.

⁶⁾ Welch L.S., Luostarinen R.: *Internationalization: Evolution of a Concept*, „Journal of General Management” 1988, vol. 14, no. 2, p. 36.

⁷⁾ Rymarczyk J.: *Internacjonalizacja i globalizacja przedsiębiorstw*, PWE, Warszawa 2004, p. 19.

⁸⁾ Pierścionek Z.: *Zarządzanie strategiczne w przedsiębiorstwie*, PWN, Warszawa 2011, p. 359.

⁹⁾ The Group of Lisbon, *op. cit.*, p. 16–17.

Table 1.1

Seven Processes of Globalization

Category	Main elements and processes
1. Globalization of finances and capital ownership	Deregulation of financial markets, international mobility of capital, rise of mergers and acquisitions. The globalization of shareholding is at its initial stage.
2. Globalization of markets and strategies	Integration of business activities on a worldwide scale, establishment of integrated operations abroad (including R&D and financing), search for components, strategic alliances.
3. Globalization of technology and linked R&D and knowledge	Technology is the primary enzyme: the rise of information technology and telecommunications enables the rise of global networks within the same firm, and between different firms. Globalization as the process of universalization of Toyotism / lean production.
4. Globalization of modes of life and consumption patterns, globalization of culture	Transfer and transplantation of predominant modes of life. Equalization of consumption patterns. The role of the media. Transformation of culture in "cultural food", "cultural products". GATT rules applied to cultural flows.
5. Globalization of regulatory capabilities and governance	The diminished role of national governments and parliaments. Attempts to design a new generation of rules and institutions for global governance.
6. Globalization as the political unification of the world	State-centred analysis of the integration of World societies into a global political and economic system led by a core Power.
7. Globalization of perception and consciousness	Socio-cultural processes as centred on "One Earth", the "globalist" movement, planetary citizenship.

Source: Broadened and revised table based on Ruigrok W. and van Tulder R., *The Ideology of Interdependence*, PhD Dissertation, University of Amsterdam, June 1993 quoted in: The Group of Lisbon, *Limits to Competition*, PIT Press, Cambridge – London 1995, p. 20.

It is rather obvious that for more than the past two decades economies have benefited from globalization processes, however, due to the global financial crisis 2007–2009, more financially-opened emerging markets seemed to fare worse than those that are more closed¹⁰⁾. Economic crises in recent years have indicated that economic globalization is increasingly experienced. The economic stagnation on one continent could lead to layoffs and downtime at the other end of the globe. Nevertheless, "the regression analysis indicates that there was no significant relationship between the change in growth in the period of the global financial crisis and the degree of financial openness of the economy in question"¹¹⁾.

Moving to the micro level, the globalization must be defined a bit differently. The globalization of a firm should be considered as one of the higher levels or degrees of the internationalization process of the enterprises, so it is even a narrower term than the above mentioned coin of multinationalization. In most cases it is reached by establishing multinational enterprises, transnational corporations, or global companies most of all. Globalization can be also considered as a business strategy heavily dependent on international economic environment and global economy. In this context, globalization is also defined as a concept of man-

¹⁰⁾ Cline W.R.: *Financial Globalization, Economic Growth, and the Crisis of 2007–09*, Peterson Institute for International Economics, Washington DC 2010, p. 235.

¹¹⁾ *Ibidem*, p. 257. To be unbiased, it is necessary to add that some analysis confirmed the negative impact (e.g. Ostry J.D., Ghosh A.R., Habermeier K.F., Chamon M., Qureshi M.S. and Reinhardt D.B.S., *Capital Inflows: The Role of Controls*, IMF Staff Position Note No. 2010/04), but they are criticized by other researchers and other analyses as having wrong methodological assumptions.

aging a global-markets-oriented company, which means managing global markets, global competition and global production factors in global business environment¹²⁾. In this context, business globalization is a higher degree of the business internationalization process!

Europeanization

While in the 1990s, economic literature focused primarily on the processes of globalization in the contemporary global economy, today Europeanization *sensu largo* is one of the main elements discussed in the context of internationalization of companies and European economic integration. Europeanization is closely linked with globalization, British scientists Geyer, Mackintosh and Lehmann define it as a *the baby brother of globalisation*¹³⁾. Making the delimitation of the scope of impact of globalization in terms of a economy, an industry and a business, these criteria can also be adopted for the concept of Europeanization. Therefore, we can argue that Europeanization is a response of the “old continent” to globalization processes occurring in the global economy. Especially in the institutional dimension, Europeanization has adopted a defensive strategy (passive strategy focusing on the survival and minimizing risks for European economy and businesses), which gradually evolved into an offensive strategy (active or expansive strategy, resulting in the development and expansion) against changes in the global economy. Europeanization is closely linked with globalization. Both of these processes coexist and can not be analyzed in isolation from each other. Similarly, one can assume that Europeanization occurs on the same dimensions, but in relation to globalization, it has a narrower range of impact.

Research on the Europeanization are dated back to 1970s, although they flourished during the last decade of the 20th century and continues today, as evidenced by bibliometric analysis performed in this field¹⁴⁾. As pointed out by Dyson, in the literature, there is no scientifically rigorous definition of the Europeanization, which still remains a relatively recent research problem causing more questions than answers¹⁵⁾. However, studying scholarly papers devoted to this issue, you can adopt a very general definition of the Europeanization built on the principle of a comparative analysis. Europeanization *sensu largo* is defined as a “developing in time” process of complex interactivity variables, resulting in diverse, interdependent, and even contradictory effects¹⁶⁾. It should be emphasized that this is a very general definition of the Europeanization, being almost metaphysical in nature, without the indication of the influencing effects of the Europeanization. The advantage of this approach to defining the Europeanization is its generality, and hence the possibility of application to the needs of almost all scientific disciplines. At least two research approaches can be applied to the process of the Europeanization. The first is the top-down approach (downloading), while the other is the bottom-up approach (uploading)¹⁷⁾.

¹²⁾ Pierścionek Z.: *op. cit.*, p. 359.

¹³⁾ Geyer R., Macintosh A., Lehmann K.: *Integrating UK and European Social Policy. The Complexity of Europeanization*, Radcliffe Publishing, Oxford 2005, p. 23.

¹⁴⁾ The results of bibliometric analysis of the circulation of the concept of the Europeanization in the scientific literature are discussed, among others, in the study: Featherstone K., *In the Name of Europe* Published in: *The Politics of Europeanization*, ed. Featherstone K., Radaelli C.M., Oxford University Press, Oxford 2003, pp. 5–6.

¹⁵⁾ Dyson K.: *Introduction: EMU as Integration, Europeanization and Convergence* Published in: *European States and the Euro. Europeanization, Variation and Convergence*, ed. Dyson K., Oxford University Press, Oxford – New York 2002, p. 3.

¹⁶⁾ *Ibidem*.

¹⁷⁾ Dyson K., Goetz K.H.: *Living with Europe: Power, Constraint and Contestation* [in:] *Germany, Europe and the Politics of Constraint*, ed. Dyson K., Goetz K.H., Oxford University Press, New York 2003, series: “Proceeding of the British Academy” 2003, vol. 119, p. 15–16.

The term “Europeanization” refers to several phenomena that are currently on the European continent. Although Olsen emphasizes that Europeanization is not *sui generis* a phenomenon, however trying to explain it through the prism of three planes, which he calls phenomena¹⁸⁾. It is worth to make clean up areas of impact the Europeanization, that is, to attempt the identification and structuring dimensions of the Europeanization. In this context, one may be tempted to distinguish eight dimensions of the Europeanization (see Table 1.2.). This concept is in fact used to describe changes in many dimensions of life, including geographical, sociological, political, legal, institutional, or economic ones¹⁹⁾. Economic dimensions are particularly interesting because of the nature of this book.

Table 1.2

Eight Dimensions of Europeanization within the European Union

Dimension	Main Processes
Europeanization in the geographical sense	The admission of new countries to the EU, and thus broadening the impact area of the Community institutional system. The spread of the idea of the Community as a supranational entity to third countries, including non-European ones.
Europeanization in the sociological sense	Adoption of European customs, practices, lifestyle. Creating a European common identity. The spread of the values of modern European civilization on the non-European countries.
Europeanization in the political sense	Transmission of the national power and measures by the member states to the Community. Spread of the Community norms, rules and political beliefs on third countries, including non-European ones.
Europeanization in the legal sense	Transposition of EU law into the national legal system. The direct applicability of Community law in member states. Convergence of the legal order of the member states.
Europeanization in the institutional sense	Activities aimed at creating a "common Europe" - a strong, united and playing a significant role in world politics. Ultimately, the recognition of the European Union as a separate entity under the international law, possibly also in the federation context.
Europeanization in the macroeconomic transcendental sense	Creating the European Union as the global economic leader, especially in the aspect of the Triad (the United States – Europe – Asian Countries).
Europeanization in the macroeconomic immanent sense	Making European business environment favourable to the development of entrepreneurship, but also the convergence of macroeconomic systems of particular member states, including in-depth economic and monetary integration.
Europeanization in the microeconomic sense	The introduction of the internationalization strategy of businesses in the European scale (Europeanization of economic activities as a result of implementation of the EU freedom of establishment).

Source: Wach K.: *Wymiary europeizacji i jej kontekst*, „Zeszyty Naukowe Uniwersytetu Ekonomicznego w Krakowie”, nr 852 (2011), p. 34.

The Europeanization in economic terms is perceived differently. The Europeanization in macroeconomic transcendent (exogenous) terms is on the one hand the creation of Europe (more precisely, the European Union), a significant economic hub in the world often associated with

¹⁸⁾ Olsen J.P.: *The Many Faces of Europeanization*, “Journal of Common Market Studies” 2002, vol. 40, no. 5, p. 922.

¹⁹⁾ Wach K.: *Wokół pojęcia europeizacji*, „Horyzonty Polityki” 2010, no. 1, p. 203.

the intensification of the European Union's role in the so-called Triad²⁰⁾. The Europeanization in macroeconomic immanent (endogenous) terms is the creation of on one hand, favourable conditions for business growth and development within the European Union (European business environment, more precisely, the Europeanization of business environment), on the other hand convergence of macro-economic systems of particular member states of the Community.

By contrast, in terms of microeconomics²¹⁾, the Europeanization is a process the internationalization of a business in Europe through its expansion into the European Union markets (a business activity in the common market, the so-called Single European Market). Similarly, Harris and McDonald define Europeanization, whereby it can be identified with the internationalization in the context of Europe²²⁾. These authors also emphasize that the Europeanization of companies is a complex and evolutionary-based learning. According to them, the Europeanization of companies have similar implications which the internationalization of enterprises, the implementation of more advanced forms of expansion in the case of the Europeanization can occur much earlier (faster) than in the case of internationalization – “(...) more complex modes of entry such as direct foreign investments may begin early in the Europeanization process (...)”²³⁾.

Similarly – as in the case of the internationalization – one can, regarding to the company, define the Europeanization as the internationalization of a business in Europe (the European Union), specifically in the spatial scope of Single European Market, consisting today of 31 countries (EU-27, EEA-3 and Switzerland as an observer). So in that sense, the concept of the Europeanization is also narrower than the internationalization, but due to the trends of the internationalization of businesses in the modern economy and by creating favourable conditions for the functioning of enterprises in the markets of all EU member states, which *per se* contribute to the internationalization in the European dimension.

The Triad: Internationalization – Europeanization – Globalization

While discussing ongoing processes it seems to be reasonable to indicate the context, in which these processes occur. Various processes, such as internationalization, globalization and Europeanization are overlapping in here. Sorting these terms out by illustrating interdependencies between them at the macro level leads us to the following statements (figure 1.1)²⁴⁾:

- internationalization is the oldest and broadest term, including any single international operations as well as those quite sophisticated ones,
- globalization is a narrower term, as it does not include exports onto individual markets or mutual and cross-border cooperation,
- globalization is the opposite process to regionalization, which altogether constitute the two poles of the one process called “globalization-regionalization”, the current state in which the present day economy is characterized by Ghemawat as semiglobalization²⁵⁾

²⁰⁾ Currently, the EU share in world trade is larger than the US.

²¹⁾ Europeanization in terms of microeconomics is identified with the Europeanization of businesses.

²²⁾ Harris Ph., McDonald F.: *European Business & Marketing*, 2nd ed., SAGE Publications, London – Thousand Oaks – New Delhi 2004, p. 73.

²³⁾ *Ibidem*, p. 73.

²⁴⁾ For the construction of the model the following study was used: Daszkiewicz N., *Internacjonalizacja małych i średnich przedsiębiorstw we współczesnej gospodarce*, Scientific Publishing Group, Gdańsk 2004, p. 22–23.

²⁵⁾ Ghemawat P.: *Redefining Global Strategy: Crossing Borders in a World Where Differences Still Matter*, Harvard Business School Press, Boston 2007, p. 10.

(explained as the state between globalization conceived as global standardization and regionalization conceived as regional adaptation),

- Europeanization is a much more narrower term, it relates to a process partially located in the globalization process, and partly in the regionalization, it seems to be the European Union's response to the ongoing processes, it is a process much more wider than the advanced stage of economic integration (that is much more than just the Single European Market, SEM).

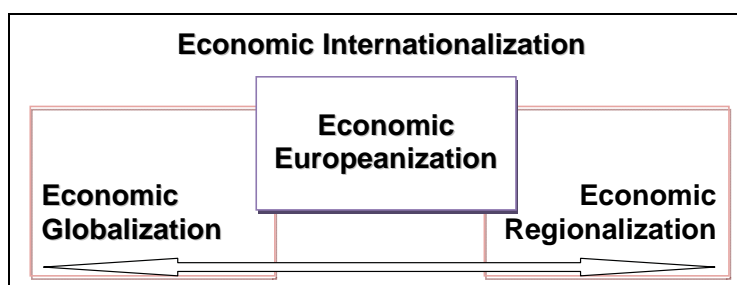


Fig. 1.1. Macroeconomic Relational Triad of the Ongoing Economic Processes in the World's Economy
Source: Own study

Moving to the micro level, the internationalization process (internationalization of a firm), it is obvious that business internationalization *sensu largo* is the widest coin including all activities, levels and degrees of any internationalization operations made by any business unit (fig. 1.2). The business internationalization *sensu stricto* should be introduced as the narrowest term including only the single and simple international transactions done within short distance, usually to the neighbouring countries. Business Europeanization is a wider term in the context of territorial expansion meaning any business activities concerning international operations or issues within the European Union, and in different continents it would be equivalent to multinationalization. Business globalization is considered to have the widest meaning in the context of territorial international expansion. It is treating the global market as the main operational market for an internationalizing business unit.



Fig. 1.2. Microeconomic Relational Triad of the Business Internationalization Process
Source: Own study

1.2. Influence of the Internationalization Processes on SMEs

During the last three decades SMEs²⁶⁾ have played a crucial role in national economies. Nowadays they seem to be predominant – in terms of employment and job creation. Moreover, SMEs are dynamic and flexible – they adapt quite easily to unstable and risky economic conditions.

However, in the face of continuous liberalization of worldwide trade, even within the actual global financial crisis, the global competition will increase. Thus, it seems necessary to seek response to such questions as: what are the new challenges faced by SMEs in the era of globalization? how are SMEs impacted by globalization? how can SMEs react and what they do to adapt to the challenges?

There is no doubt, that the continuous processes of internationalization and globalization mean both chances and threats for SMEs. Chances exist in the abilities to export, new market entries and foreign cooperation. In turn, risk means that also SMEs regionally or nationally oriented may face an increasing number of potential foreign competitors in their home market.

According to SME Observatory²⁷⁾ the principal motivation for SME internationalization is the wish to improve the competitiveness of the firm, first of all the intention to get access to new, larger markets. This can be caused by different factors. The assumption that internationalization process of a firm is determined by its growth is the key one in many theoretical approaches. For instance, OECD²⁸⁾ in its report points at four factors accelerating internationalization and globalization of SMEs. However, entrepreneurial factor (seeking growth) seems to be the most important. If owner-manager is oriented for firm's growth he/she may try to enter foreign markets.

In turn, so – called push factor is connected with disability of a firm to achieve growth in domestic market. Push factor is sometimes described as negative factor, forcing the company to leave the competitive market; pull factor is about perceiving an opportunity in foreign markets or takes place when the demand for a product of the company appears just in the foreign market. Pull factor is sometimes called a positive factor. Chance factor, in turn, is connected with making use of appearing opportunities in a foreign market. However, it must be stressed that entrepreneurial factor is the most important one, without which the functioning of the other factors would not be possible (figure 1.3).

²⁶⁾ In the European Union enterprises qualify as micro, small and medium-sized enterprises (SMEs) if they fulfil the criteria laid down in Recommendation 2003/361/EC which are summarized in the below presented table. In addition to the staff headcount ceiling, an enterprise qualifies as an SME if it meets either the turnover ceiling or the balance sheet ceiling, but not necessarily both. If an enterprise does not fulfil the criteria for an SME, it is a large-scale enterprise (LSE). For statistical purposes, enterprises are classified with the use of the headcount criterion only.

Size	Headcount	Turnover	or	Balance Sheet Total
Medium-sized enterprise	< 250	≤ 50 mln euro		≤ 43 mln euro
Small enterprise	< 50	≤ 10 mln euro		≤ 10 mln euro
Microenterprise	< 10	≤ 2 mln euro		≤ 2 mln euro

Source: Recommendation of the European Commission no. 2003/361/EC of 6 May 2003 regarding the SME definition.

²⁷⁾ *SME Observatory Survey Summary*, "Flash Eurobarometer" No. 196, European Commission, May 2007.

²⁸⁾ *Globalisation and Small and Medium Enterprises*, OECD, Paris 1997.

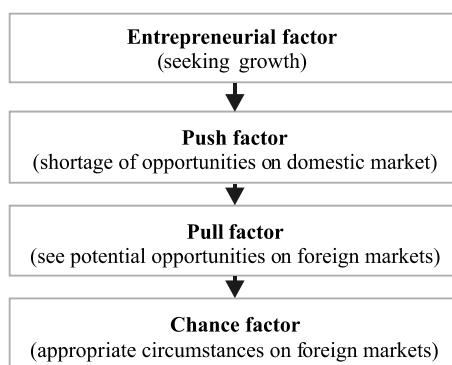


Fig. 1.3. Internationalization Factors

Source: own study

The next source of motivation, besides the access to new markets, is the development of the firm²⁹⁾. In order to become competitive, SMEs try to improve the innovative potential in order to introduce new products/services to the market. Some firms are also looking for access to new markets indirectly – via co-operation. Thanks to the use of international resources SMEs improve their competitiveness, getting access to:

- 1) international competence and resources (technologies, know-how etc.);
- 2) international business relations, including educational elements within the framework of common research and development programmes/innovations and knowledge sharing;
- 3) capital from foreign markets.

Access to know-how and technologies favours internationalization, on the other hand SMEs undertake export activities in order to acquire knowledge or technology. It is worth to stress that access to know-how and technology is a frequent argument among firms which are only involved in imports and it is the second most important motivation quoted by SMEs which use more sophisticated forms of internationalization³⁰⁾. Among the SMEs, which are also involved in export activities only, over one third internationalize in order to acquire knowledge. Thus the decision about active internationalization does not exclusively result from the intention to increase sales or to acquire access to new markets. Internationalization is a way to acquire know-how and insight into new technologies in order to strengthen the competitive position of the firm. It is then a form of widely conceived innovativeness.

Even if SMEs have to adjust to increasing global competition, still there is a question of how to do it. Ch. Stehr argues that growing number of small firms develop entrepreneurial globalization strategy³¹⁾. The researcher also stresses that there is a difference between entrepreneurial internationalization and entrepreneurial globalization. Entrepreneurial internationalization (internationalization of businesses) is already reached if a firm supplies markets in two more countries. In turn, the entrepreneurial globalization is the economic

²⁹⁾ *SME Observatory...*, *op.cit.*

³⁰⁾ More about forms of internationalization in chapter 3.3.

³¹⁾ Stehr Ch.: *Small and Medium-Sized Enterprises and Their Globalization Strategy*, Published in: *Internationalization, Innovativeness and Growth of Modern Enterprises*, Harvard Business Review Polska ICAN sp. z o.o., Warszawa 2010, p. 34.

process of enlargement the existing international activities to global extent. The analysis of the globalization potential of particular SMEs requires the following analysis (figure 1.4):

1. The globalization potential usually develops out of firms' willingness to adjust and adapt to the global conditions (law, culture, administration) and worldwide (political/economic) situation. Moreover, the willingness to adjust requires gradual development and has to be elaborated systematically.
2. There is a direct relation between the possibility of entrepreneurial globalization and the organizational structure and human resources of the firm. It comprises general organizational and structural capacities of the firm, qualification of the employees and especially the willingness of the management/owner-manager to take additional costs for foreign expansion.
3. The problem of financing the foreign and global activities is also a key criterion for decision if there is a positive or negative potential of globalization of a SME.
4. Thus, the competence and ability for entrepreneurial globalization refers to the particular resources, the aims of the firm, the business segment and the position of the SME in the competition (using eg. The five-force model, SWOT analysis an portfolio analysis)³²⁾.

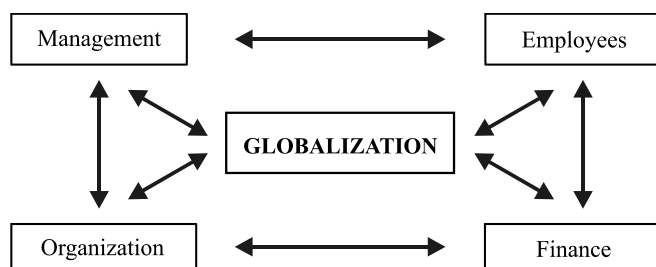


Fig. 1.4. Relevant Sections for Entrepreneurial Globalization

Source: Stehr Ch., *op.cit.*, p. 36.

1.3. European SMEs Facing the Internationalization Processes

1.3.1. SMEs in European Economy³³⁾

Within the non-financial business economy enterprise population, over 92% are micro enterprises. Thus, the typical European firm is a micro firm. There are about 1.4 million small enterprises, representing almost 7% of the stock. About 1% (219 252) of enterprises are medium-sized. On average, an enterprise in the EU provides work for 6.4 persons; within individual size-classes, the average size of an enterprise varies between only 2 in micro enterprises and about 1 000 in large scale enterprises (LSEs)³⁴⁾ (table 1.3).

Over the period of 2002–2008, the number of SMEs in the EU has grown faster than the number of LSEs, with the micro and small enterprises displaying the highest growth

³²⁾ *Ibidem*, pp. 35–36.

³³⁾ *European SMEs under Pressure. Annual Report on EU Small and Medium-sized Enterprises*, European Commission, Brussels 2009; *Are EU SMEs recovering? Annual Report on EU Small and Medium-sized Enterprises*, Rotterdam, Cambridge, 2011.

³⁴⁾ *European SMEs ...*, *op. cit.* s. 15.

rates. The number of SMEs increased by 2.4 million and the number of large enterprises by 2 000 enterprises. Changes in the number of enterprises are to a large extent due to enterprise birth and death, and their underlying determinants. In addition, mergers and split-ups play some role as well. The development of the number of enterprises by size class also differs across sectors of industry. The highest absolute growth in the number of SMEs occurred in real estate, renting and business activities.

Table 1.3

Role of SMEs in European Economy (EU-27) in the year 2010:
Number of Enterprises, Employment (2010) and Occupied Persons per Enterprises (2008),
by Size Class in the Non-Financial Business Economy

Criterion	Micro	Small	Medium-sized	SMEs	Large	Total
Enterprises						
Number	19 198 539	1 378 401	219 252	20 796 000	43 034	20 839 226
%	92.1	6.6	1.1	99.8	0.2	100.0
Employment						
Number	38 905 519	26 605 166	21 950 107	87 460 792	43 257 098	130 717 890
%	29.8	20.4	16.8	66.9	33.1	100.0
Occupied persons per enterprise						
Persons	2.1	19.4	100.3	4.3	1006.1	6.4

Source: *European SMEs under Pressure. Annual Report on EU Small and Medium-sized Enterprises*, European Commission, Brussels 2009. p. 15; *Are EU SMEs recovering? Annual Report on EU Small and Medium-sized Enterprises*, Rotterdam, Cambridge, 2011, p.8.

Table 1.4

Role of SMEs in European Economy (EU-27) in the years 2008–2010:
Annual Growth Percentages for Number of Enterprises, Employment and Gross Value added (estimates)

Year	Micro	Small	Medium	SMEs	Large	Total
Enterprises						
2008	2.1	1.3	0.7	2.0	2.0	2.0
2009	–2.0	–3.2	–3.1	–2.1	–3.1	–2.1
2010	0.1	–1.0	–1.1	0.0	–0.9	0.0
Employment						
2008	1.9	1.1	0.7	1.3	1.9	1.5
2009	–2.0	–3.4	–3.2	–2.7	–2.9	–2.8
2010	–0.8	–1.0	–1.0	–0.9	–0.6	–0.8
Gross value added						
2008	1.6	1.2	0.1	1.0	–0.2	0.5
2009	–4.8	–6.3	–8.5	–6.4	–7.6	–6.9
2010	2.6	3.1	4.6	3.4	4.8	3.9

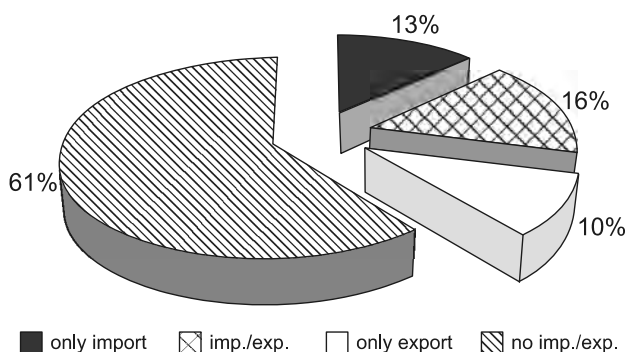
Source: *Are EU SMEs recovering? Annual Report on EU Small and Medium-sized Enterprises*, Rotterdam, Cambridge, 2011, p.11

In all size classes the large decline of production in 2009 is probably unprecedented since the 1930s (table 1.4). The recovery was most pronounced in the medium-sized class, presumably because they are relatively more involved in exporting than small and micro enterprises³⁵⁾. Employment in SMEs kept declining in 2010 by 0.9% following even steeper decline in 2009 (–2.7%). The largest declines in SME employment were in manufacturing, construction and real estate. In all sectors SME employment decreased in 2009 except for hotels and restaurants. In large enterprises all sectors showed lower employment in that year.

1.3.2. Internationalization of European SMEs ³⁶⁾

The goal of the latest study of European Commission was to provide an updated and comprehensive overview of the level of internationalization of European SMEs. In this study internationalization refers not only to exports³⁷⁾ but to all activities that put SMEs into a meaningful business relationship with a foreign partner: exports, imports, foreign direct investment, international subcontracting and international technical co-operation. The data and conclusions of this study were based on a survey of 9,480 SMEs in 33 European countries during Spring 2009.

Nowadays, more than 40% of European SMEs are involved in some form of international relationship. The percentages vary from nearly 30% of SMEs that import to only 2% of SMEs having foreign direct investments. Only 4% of SMEs have plans to become internationally active in the coming years (table 1.5). Importing and exporting very often coincide within the same enterprises. Of all enterprises that either import or export, more than 40% are active with both modes as shown in figure 1.5.



* Non EU-Members refers exclusively to the countries considered in this survey: Croatia, Iceland, Liechtenstein, FYROM, Norway and Turkey.

Fig. 1.5. Percentage of SMEs with Direct Exports and/or Imports in 2006–2008

Source: Survey 2009 – EIM/GDCC (N=9480) quoted in: *Internationalisation of European SMEs, Final Report*, European Commission & EIM Business, Zoetermeer – Brussels 2010

³⁵⁾ *Are EU ...*, op. cit., p.6

³⁶⁾ *Internationalisation of European SMEs. Final Report*, European Commission, Brussels 2010.

³⁷⁾ In previous reports: 1) The 2003 Observatory of European SMEs study – “Internationalisation of SMEs” and 2) The Flash Eurobarometer “Observatory of European SMEs” of 2007 focused on export activity of SMEs.

Table 1.5

Percentage of European SMEs (Europe-33*) Involved in International Business Activities Having Concrete Plans to Start Such Activities or None At All. For Various Modes of Internationalisation

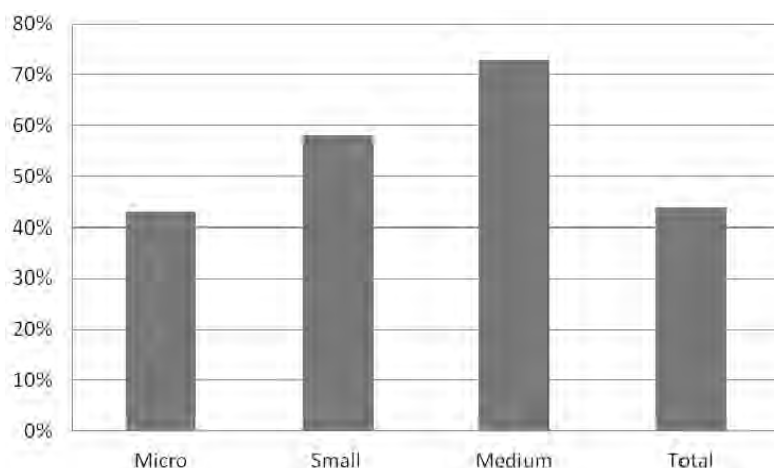
Criterion	Active	Plans to start
Import	30%	3%
Export	26%	4%
Technological cooperation	8%	4%
Being subcontractor	8%	4%
Having subcontractor	7%	3%
Foreign direct investment (FDI)	2%	4%

* Non EU-Members refers exclusively to the countries considered in this survey: Croatia, Iceland, Liechtenstein, FYROM, Norway and Turkey.

Source: Survey 2009 EIM/GDCC (N=9480) quoted in: *Internationalisation of European SMEs, Final Report*, European Commission & EIM Business, Zoetermeer – Brussels 2010.

Different modes of internationalization have been studied for the period 2006–2008: import export, foreign direct investments (having establishments abroad), technological cooperation with enterprises abroad; acting as subcontractor for a foreign main contractor and having foreign subcontractors³⁸⁾.

The percentage of SMEs that is involved in international activities is related to the size of the firm (in terms of number of workers). For each mode of internationalization the percentage of SMEs increases by firm size (fig. 1.6).



*EU-27 + Non-EU-6 while Non EU-Members refers exclusively to the countries considered in this survey: Croatia, Iceland, Liechtenstein, FYROM, Norway and Turkey

Fig. 1.6. Percentage of internationalised SMEs in 2006–2008 by size of firm

Source: Survey 2009 – EIM/GDCC (N=9480) quoted in: *Internationalisation of European SMEs, Final Report*, European Commission & EIM Business, Zoetermeer – Brussels 2010

³⁸⁾ More about modes of internationalization in chapter 3.3.

Further analysis of the Report leads to the following conclusions:

1. The relationship of each mode of internationalization to size class is quite pronounced:
 - The share in exporting; importing or active in subcontracting is at least twice as high for medium-sized enterprises as for micro enterprises.
 - Medium-sized enterprises are three times more active in technical cooperation than micro enterprises.
 - For FDI there is really a large difference, by size class micro 2%, small 6% and medium-sized 16%.
2. The smaller the country, the more its SMEs are internationalized, but the SME's proximity to a national border does not have much effect on its level of internationalization.
3. There is a negative correlation between the size of the SME's home country population and its level of international activity. Countries such as Estonia, Denmark, Sweden, the Czech Republic and Slovenia have a much higher percentage of exporters than the EU average of 25%. Germany, France and UK score below average.
4. SMEs located close to a border show much higher activity rates with their cross border regions but this is not followed by being more internationally active in general.
5. Trade, manufacturing, sale of motor vehicles, transport and communication and research are the most internationalised sectors.
6. Exporting and importing activities increase in intensity by age of enterprise. The percentages of SMEs that are exporting gradually increases from just over 15% for enterprises up to 4 years of age to nearly 30% for enterprises that have existed for 25 years or more. Most often SMEs start international activities by importing.
7. Partner countries are mostly other EU countries. Except for imports from China, relations with BRIC countries are generally underdeveloped.

European Context of the Internationalization

2.1. European Freedom of Establishment

The principles of the European economic freedom, including the freedom of establishment, are in force in 31 countries sanctioning the mechanisms of the single market (EU-27, EEA-3 and Switzerland). According to the Single European Act (SEA), signed on 17 February 1986 in Luxembourg, and then the Treaty establishing the European Community (TEEC), signed on 7 February 1992 in Maastricht, the European single market is defined as ‘an area without internal frontiers in which the free movement of goods, persons, services and capital is assured’ (SEA, Art. 7a and TEEC, Art. 3, section 1, subsection C; Art. 14, section 2)¹⁾. Moreover, the Charter for Fundamental Rights of the European Union, proclaimed in Nice on 8 December 2000, has great significance for the European freedom of establishment. It confirmed the guarantee of the right of free movement and the freedom to every citizen of the European Union to conduct a business in the whole territory of the Community²⁾. It introduces *explicite* the notion of economic freedom, however, in particular it refers to the legislation of the individual member states of the European Union. So far, a lot has been achieved in the scope of the economic freedom in the European Union, yet there is still a lot to be done.

The single internal market of the European Union is implemented on the basis of four pillars being four basic freedoms, namely the freedom of movement of people, the freedom of movement of goods, the freedom of movement of capital and the freedom to provide services. The four basic freedoms of the single market are complemented with two additional freedoms, namely the freedom of establishment (TEEC, Art. 43–48, currently TFEU, Art. 49–54), and the freedom of access to public procurement, regulated in twenty directives (Fig. 2.1).

¹⁾ Single European Act (O.J. EC L 169 of 29.06.1987) as well as the Treaty establishing the European Community, (O.J. EC C 235 of 24.12.2002) – currently the Treaty on the Functioning of the European Union (O.J. EU C 83 of 30.3.2010).

²⁾ Charter of Fundamental Rights of the European Union (O. J. EC C 364 of 18.12.2000).

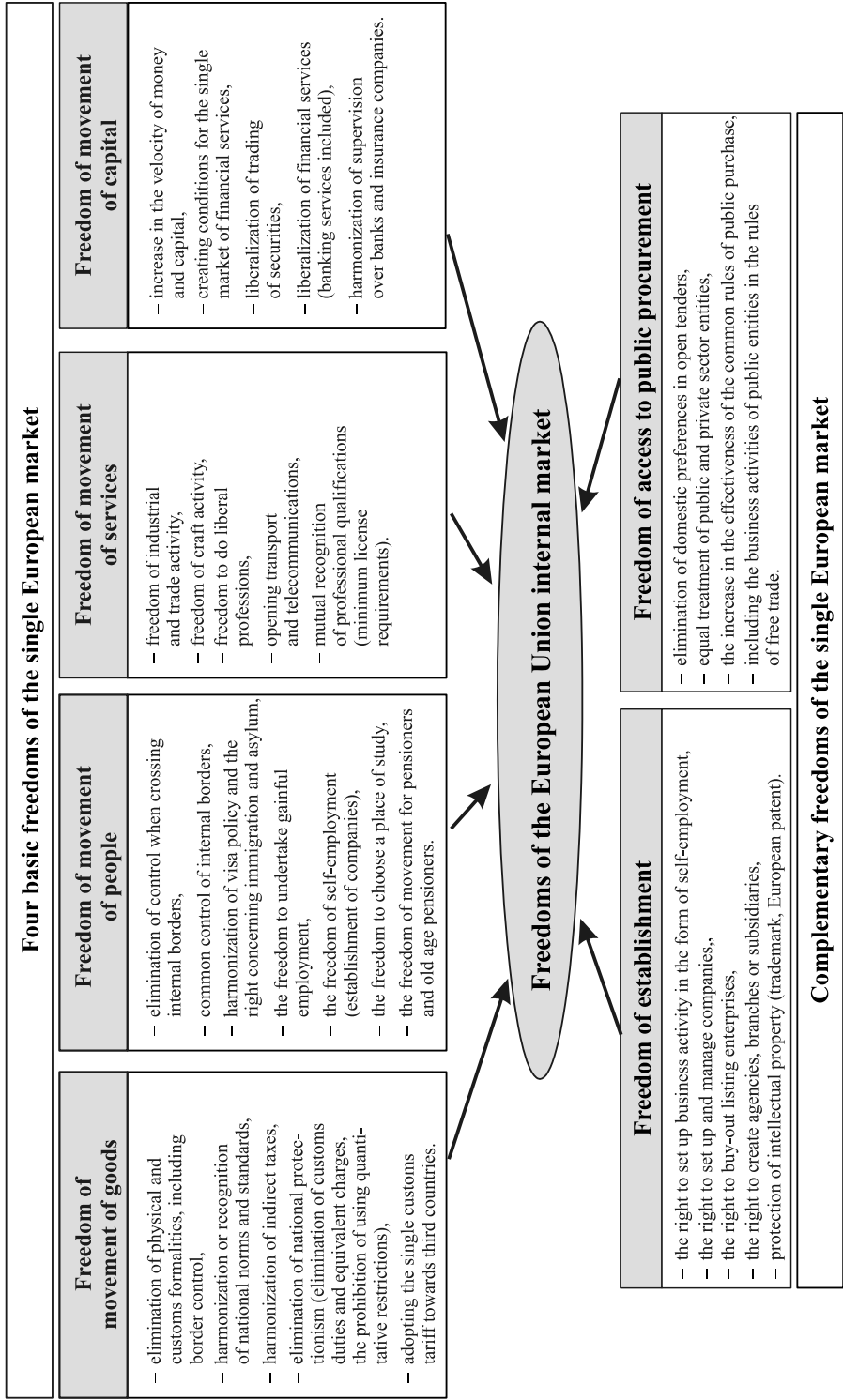


Fig. 2.1. The freedoms of the single European market
Source: Wach K.: Europejski rynek pracy, Wolters Kluwer Polska, Warszawa 2007, p. 21

The Treaty on the Functioning of the European Union (TFEU) uses the English notion *freedom of establishment*³⁾, which in some languages is sometimes interchangeably called “freedom to conduct a business”, “freedom of economic activity”, “freedom to establish enterprises”, or “freedom for entrepreneurship”. None of these notions is predominant, as all of them are synonyms, and none of them is more substantially accurate. The Community legislation includes the direct prohibition of unfair discrimination (so-called direct prohibiting order) of citizens of other member states in the issues connected with establishing and conducting business activity by them in all member states of the Community. “Within the framework of the provisions set out below, restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited. Such prohibition shall also apply to restrictions on the setting-up of agencies, branches or subsidiaries by nationals of any Member State established in the territory of any Member State”. (TEEC, Art. 43, currently TFEU, Art. 49). The Community law provides for a derogation from this principle on the grounds of:

- public policy,
- public security (e.g. threat of terrorism),
- public health (e.g. carrier state of infectious diseases).

The European freedom of establishment results in the freedom to choose localization and the freedom of the legal form (including both the ones existing in a specific country, and the pan-European forms). The freedom of establishment⁴⁾ may have the primary and the secondary character. The primary freedom means undertaking a business activity in an independent way, whereas in the secondary freedom the level of independence of a business entity established in any of the member states does not matter (it is mainly about the establishment of subsidiaries or the buyout of a certain maximum amount of shares in already existing entities). The beneficiaries of the freedom of establishment are both natural and legal persons and organizational units possessing no legal personality, which pursuant to separate regulations have gained the legal capacity (it concerns mainly partnerships). The freedom of establishment entitles natural persons to:

- undertake and perform independent gainful activity by doing liberal professions or by self-employment,
- establish and run one’s own enterprise and employ other workers in it,
- establish and run an overseas branch, subsidiary and agency.

On the other hand, legal persons and companies not possessing legal personality are entitled to establish and run representations and independent and dependant agencies (including branches, subsidiaries, affiliates, joint ventures companies) and to employ workers in them.

When discussing the issues related to running business activity in the European Union, one must differentiate between cross-border service provision and service activities. It is necessary to use the criterion of temporariness and frequency here. If providing services is of regular and repetitive character, it may be qualified by individual member states as business activity. On one hand, contrary to establishing enterprises, the freedom of service

³⁾ German: *Niederlassungsfreiheit*, French: *liberté d’établissement*, Italian: *diritto di stabilimento*, Spanish: *derecho de establecimiento*, Polish: *swoboda przedsiębiorczości*.

⁴⁾ Further reading: Wach K.: *Swoboda przedsiębiorczości w Unii Europejskiej*, [in:] *Wspólna Europa. Tworzenie wartości przedsiębiorstwa na rynku Unii Europejskiej*, ed. Brdulak H., Duliniec E., Gołębiowski T., Oficyna Wydawnicza Szkoły Głównej Handlowej, Warszawa 2007.

provision is not related to the permanent investment in infrastructure, since it assumes only temporary character of a service, but on the other hand, it is related to crossing the internal borders of the EU. The establishment of a service company in one of the EU member states is equal to the permanent inclusion in the economic system of that state.

The freedom of establishment by virtue of association agreements is also guaranteed for the citizens of associated states (in the territory of the member states) and the European Union citizens (in the territory of the associated states).

The effects of introducing the European single market are, among others, the change in the localization of enterprises, establishing cooperation with overseas partners, or the internationalization of the production activity of enterprises⁵⁾. European businesses may profit from the single market fully and in the same way as Union firms, which includes, among others, a possibility to sell goods in the whole area of the EU without necessity to perform additional tests and certifications of products on the basis of mutual recognition, greater possibilities to establish cooperation contacts among enterprises from various EU member states, or the facilitation in the process of free establishment of enterprises and their branches in all the member states of the European Union by Polish entrepreneurs.

2.2. Community Legal Forms of Doing Business in the European Union

The Community actions aim at standardization of the majority of regulations in the area of the single market, also in the scope of organizational and legal forms of conducting business activity. The result of these actions is gradual introduction of organizational and legal frames of business activity which are uniform for the whole territory of the European Union. So far, the Union law has regulated three pan-European legal forms, namely: the European company, the European Economic Interest Grouping, the European Cooperative Society. Unfortunately, these proposals mostly addressed to large economic entities, or agricultural activity. However, the Community is striving at the introduction of three more legal forms which will fully correspond to the needs of small and medium-sized enterprises (the European private company, among others). In 2003, the European Commission announced that it would also commence preliminary works on the project of the European foundation act (which would be already the seventh pan-European form)⁶⁾. Pan-European companies (see: Table 2.1) are regulated in the Union legislation which must be applied by the member states directly. The national law is applicable only in the issues not defined in the Union law, which include, among others, the tax system, accounting or the labour law.

⁵⁾ *The European Observatory for SMEs*, European Commission, Brussels 1993, p. 81.

⁶⁾ *Modernising Company Law and Enhancing Corporate Governance in the EU (Company Law Action Plan)*, Communication from the Commission to the Council and the European Parliament, COM(2003) 284, Brussels – 21 May 2003

Table 2.1

Characteristics of Pan-European Legal Forms of Doing Business

Forms Criteria	European Economic Interest Grouping	European Company	European Cooperative Society	European Private Company (proposal only)
Launching year	since 1989	since 2004	since 2006	to be accepted (proposal only)
Abbreviation	EEIG (national abbreviations are used)	SE (Latin <i>Societas Europaea</i>)	SCE (Latin <i>Societas Cooperativa Europaea</i>)	SPE (Latin <i>Societas Privata Europaea</i>)
Purpose	represent the eco- nomic interests of affiliated members, not generating profits	business activities throughout the EU on a large scale	joint projects implementation (even short-term or disposable)	business activities throughout the EU
Partners	at least 2 members (individuals, any legal entities), member states may limit the maximum number of members	conversion of an existing capital com- pany, however, only in five specific cases.	at least 5 individuals or legal entities	at least 2 partners (individuals or other legal entities)
Registration	in the commercial register in the member state, in which the headquarter of the company is localised, requirement that the fact of registration is announced in O.J. EU	in the commercial register in the mem- ber state, in which the headquarter of the company is localised, requirement that the fact of registration is announced in O.J. EU	in the commercial register in the mem- ber state, in which the headquarter of the company is localised, require- ment that the fact of registration is an- nounced in O.J. EU	in the commercial register in the mem- ber state, in which the headquarter of the company is localised, require- ment that the fact of registration is an- nounced in O.J. EU
Legal entity	may have a separate legal entity, if national law introduces such a solution	separate legal entity	separate legal entity	separate legal entity
Size	small, medium or large (maximum 500 employees)	large or medium	small or medium	micro, small or me- dium
Minimal capital	not specified (just in-kind contribution is accepted)	at least 120 000 euro	at least 30 000 euro	at least 1 euro
Structure	far-reaching freedom, but the mandatory two bodies: – members acting collectively, – at least one man- ager.	1) choice one of the alternatives: a) two-tier system (a management board and a su- pervisory board) b) one-tier system (an administrative board); 2) additionally, a general meeting of the SE is provided	1) choice one of the alternatives: a) two-tier system (a management board and a su- pervisory board), b) one-tier system (an administrative board); 2) additionally, a general meeting of partners is pro- vided	any (EU regulations do not provide any mandatory authority)

Source: Wach K.: *Europeizacja małych i średnich przedsiębiorstw*, Wydawnictwo Uniwersytetu Ekonomicznego w Krakowie, Kraków 2008, p. 55–56.

European Economic Interest Grouping

The European Economic Interest Grouping (EEIG)⁷⁾ is an institutionalized form of cooperation among entrepreneurs from various member states of the European Union (it is sometimes compared to the cooperation agreement)⁸⁾. It is an indirect form between a partnership and a company, and the articles of incorporation of the grouping are similar to a commercial company agreement. On the Community level, it is regulated by the Council Regulation No. 2137/85/EEC of 25 April 1985 on the European Economic Interest Grouping (EEIG)⁹⁾. In Poland, it is regulated in the Act of 4 March 2005 on the European Economic Interest Grouping and a European Company¹⁰⁾ and, to some extent, in the Code of Commercial Companies. The aim of a grouping is not to generate profit, but to represent economic interests of the associated members, owing to which EU companies may involve more in the trade among member states. A grouping should include at least 2 members (the limitation to 20 members may be applied, but the Polish legislator did not indicate the maximum limit¹¹⁾) and they can be both natural persons and enterprises from various member states. Cash capital is not required, contribution in kind is enough. The entity is subject to registration in the national register of enterprises (in Poland it is National Court Register, KRS). The fact has to be published by giving the adequate information in the national official journal, and then in the Official Journal of the European Union (series C and S). EEIG cannot employ more than 500 people. In some countries, the grouping is granted the legal personality (e.g. France, Belgium). The EEIG organizational structure may be basically shaped freely by its members, however, two bodies are obligatory, these are: the members acting collectively (so called the assembly of members) and at least one manager. The grouping is included in the tax system enabling unlimited deduction of loss from company gains (so called *transparencia fiscal*), which is its main advantage. Moreover, it is excluded from stamp duties, so it is possible to contract liabilities and perform the remaining legal acts. This form, however, does not attract European entrepreneurs, mainly due to non-profitable character because this company cannot generate profit.

European Company

A European company (the official abbreviation: SE – Latin *Societas Europaea*)¹²⁾ is a pan-European company constituting the European equivalent of a national joint-stock company. A European joint-stock company, existing in the Union law since 8 October 2004 and

⁷⁾ German: *Europäische wirtschaftliche Interessenvereinigung* (EWIV), French: *Groupement européen d'intérêt économique* (GEIE), Italian: *Gruppo Europeo di Interesse Economico* (GEIE), Spanish: *Agrupación europea de interés económico* (AEIE), Polish: *europejskie zgrupowanie interesów gospodarczych* (EZIG).

⁸⁾ Santa Maria A.: *European Economic Law*, Wolters Kluwer International, Alphen 2009, p. 173.

⁹⁾ Council Regulation No. 2137/85/EEC of 25 April 1985 on the European Economic Interest Grouping (EEIG), (O.J. EC L 199 of 31.07.1985).

¹⁰⁾ Dz.U. 2005, Nr 62, poz. 551.

¹¹⁾ A member state may provide that groupings registered at its registries may have no more than 20 members (art. 4, p. 3 of the Council Regulation No. 2137/85/EEC op.cit).

¹²⁾ German: *Europäische Gesellschaft*, French: *Société européenne*, Italian: *Società europea*, Spanish: *Societas europaea*, Polish: *Spółka europejska*.

commonly called a European company, regardless of the country of registration, is subject to the Union law. This form is regulated by two legal acts:

1. Council Regulation No. 2157/2001/EC of 8 October 2001 on the Statute of European Company (SE)¹³⁾,
2. Council Directive No. 2001/86/EC of 8 October 2001 supplementing the Statute for a European Company with regard to the involvement of employees¹⁴⁾.

The regulation is directly applicable in each member state of the Community, and the provisions of the aforementioned directive are implemented to the national legal orders. In Poland, they are regulated in the Act of 4 March 2005 on the European Economic Interest Grouping and a European Company¹⁵⁾ and, to some extent, in the Polish Code of Commercial Companies¹⁶⁾. The Council Regulation often regulates only fragmentary principles of a European company functioning – it refers to the national regulations of a member state, which regulate the functioning of joint-stock companies. In the preamble, the European legislator does not give a reason for such a solution, and only claims that “this regulation does not include legal areas, such as tax law, anti-monopoly law, intellectual property law and bankruptcy law”¹⁷⁾. The introduction of these regulations encourages firms to pan-European activity, which in turn should contribute to the increase in the competitiveness of the Union economy in accordance with the EU strategy¹⁸⁾. A European company is a chance for a firm conducting activity in more than one member state to register it in compliance with the Union law as a community firm, which relates to the possibility to function in the whole territory of the Community on the basis of the uniform set of principles and one management system. The rules were to come into effect in all the member states on 8 October 2004 at the latest (unfortunately, at that time only three member states introduced adequate legislative acts). European companies will certainly differ from each other, depending on the Community state in which they will be established. The attractiveness of the solutions adopted by individual member states influences the decisions of investors concerning the localization of the company seat in a given country (not to mention the measurable financial benefits for the state)¹⁹⁾.

The main premise for introducing a European company to the Union law was a possibility to integrate firms functioning in more than one member state so that they could easily conduct their activity in the whole territory of the European Union. It will contribute to entrepreneurs’ use of full facilities of the single internal market. Every European company is registered in the adequate trade register or the register of commercial companies effective in a given member state (in Poland it is the National Court Register, KRS). The announce-

¹³⁾ Council Regulation No. 2157/2001/EC of 8 October 2001 on the Statute of European Company (SE), (O.J. EC L 294 of 10.11.2001, pp. 1–21).

¹⁴⁾ Council Directive No. 2001/86/EC of 8 October 2001 supplementing the Statute for a European Company with regard to the involvement of employees (O.J. EC L 294 of 10.11.2001, pp. 22–32).

¹⁵⁾ Ustawa z dnia 4 marca 2005 r. o europejskim zgrupowaniu interesów gospodarczych i spółce europejskiej (Dz.U. 2005, Nr 62, poz. 551).

¹⁶⁾ Ustawa z dnia 15 września 2000 r. Kodeks spółek handlowych (Dz.U. 2001, Nr 94, poz. 1037 z późn.zm.).

¹⁷⁾ Wach K.: *Jak założyć firmę w Unii Europejskiej*, Oficyna Ekonomiczna, Kraków 2006, p. 32.

¹⁸⁾ For example, previously The Lisbon strategy and currently the Europe 2020 strategy.

¹⁹⁾ Sanders P.: *The SE: Form Conception to Reality* (chapter 3) Published in: *The European Company: Developing European law of Corporations*, ed. J. Rickford, Intersentia, Antwerp – Oxford – New York 2003, p. 41.

ment of its establishment is published in the national official journal (in Poland it is *Monitor Sądowy i Gospodarczy* – *Court and Commercial Gazette*), and then in the Official Journal of the European Union (series C and S). Establishing a European company is very complex. It may be set up in five ways by²⁰⁾:

- 1) merger of at least two existing public limited companies with their seats in at least two different member states (Art. 2 section 1),
- 2) creating a holding by limited liability companies or public limited companies from at least two member states (Art. 2 section 2),
- 3) creating a subsidiary by companies or other public or private law entities from at least two different member states (Art. 2, section 3),
- 4) transforming a public limited company which has had its own subsidiary in another member state for at least two years (Art. 2, section 4),
- 5) establishing a sole subsidiary in the form of a public limited company by already existing European company (Art. 2, section 2).

The shareholders may choose one of the two internal organizational models of the company:

- two-tier system – a dualistic model of managing and controlling the company by means of the management board and supervisory board²¹⁾;
- one-tier system – a monistic model of company management by means of one management and control body called the administrative board²²⁾.

Conducting business activities in accordance with one set of rules and one management system is a definite advantage of the European company as it enables to reduce its costs of functioning. Another advantage is the requirement of only one registration because such a company has to be registered only in the member state in which it has the headquarters. A European company obtains a legal personality from entering it the national register of companies. On the registration, a European company may conduct its activity in the area of each of the member states. Establishing a European company enables easy integration of companies functioning in more than one member states. Another important advantage of a European company is its mobility. The company seat may be transferred to another member state without a necessity to dissolve or create a new organizational and legal frame, contrary to regulations mandatory for national companies. A European company is attractive only for large enterprises which conduct pan-European scale activity²³⁾.

When analysing the European company as an organizational and legal form, its advantages are as follows:

- a possibility to keep uniform accounting,
- a uniform management system,
- a possibility to balance profit and loss in the European Union countries (lower taxes),
- a possibility to transfer the company seat to other EU countries without a necessity to liquidate the company in a given member state;

²⁰⁾ Council Regulation No. 2157/2001/EC z 8 October 2001. w on the Statute of the European Company (SE), (O.J. EC L 294 of 10.11.2001, pp. 1–21).

²¹⁾ Namely so-called Germanic administrative model, in force in Poland and majority of the Continental Europe countries.

²²⁾ Namely so-called French-English administrative model with the uniform management body.

²³⁾ For details see: Oplustil K.: *Spółka europejska i europejskie zgrupowanie interesów gospodarczych*, Wydawnictwo Prawo i Praktyka Gospodarcza, Warszawa 2005.

- no requirement to register activity in the EU countries where the company enters the market;
- a possibility to choose the organizational structure of the company.

Although the opinion of the European Economic and Social Committee of 21 March 2002 confirmed that the introduction of a European company is undoubtedly a step ahead, expected for 30 years, regulations concerning this company are based on ‘the old concept’ not meeting the needs of small and medium-sized enterprises which may have difficulty in establishing it. A European company statute was originally meant for small and medium – sized enterprises, yet the amount of initial capital which was determined at 120.000 euro will probably partially limit a possibility to use this solution by small entrepreneurs (to compare, in Poland the minimum amount of the initial capital for public limited companies is similar). Moreover, the regulations concerning insolvency, bankruptcy, dissolution and liquidation of a European company are unfavourable for entrepreneurs (but very friendly for creditors). Another disadvantage of this organizational and legal frame is the validity of the Union law and national solutions at the same time, which may turn out to be complicated in practice. Also the tax status of a European company is regulated not in the Community law but in the national law.

European Cooperative Society

The European Cooperative Society (Latin *Societas Cooperative Europaea*, SCE)²⁴⁾ is established to propagate the interests of its members in the territory of the Community. It is a completely new legal form which is not reflected in the national law (created ex novo), as it is a European mixture of the national cooperative society and a company. On the Community level, it is regulated by two legal acts:

1. Council Regulation No. 1435/2003/EC of 22 July 2003 on the Statute for a European Cooperative Society (SCE)²⁵⁾,
2. Council Directive No. 2003/72/EC of 22 July 2003 supplementing the Statute for a European Cooperative Society with regard to the involvement of employees²⁶⁾.

The regulation came into effect three years after its announcement, namely as of 18 August 2006 and is valid directly in all member states. The regulations included in the directive were implemented in the national legal systems. In Poland, the European Cooperative Society is regulated in the Act of 22 July 2006 on the European Cooperative Society²⁷⁾, and partially in the Code of Commercial Companies and the cooperative law²⁸⁾. Therefore, the European Cooperative Society is a kind of a company, basically it differs from a company only with the goal for which it has been established. It is oriented at the execution of its shareholders’ rights. It conducts business activity not to its own account but to the account of its shareholders. To establish it, at least 5 natural persons or at least 2 legal

²⁴⁾ German: *Europäische Genossenschaft*, French: *société coopérative européenne*, Italian: *società cooperativa europea*, Polish: *spółdzielnia europejska*.

²⁵⁾ Council Regulation No. 1435/2003/EC of 22 July 2003 on the Statute for a European Cooperative Society (SCE), (O.J. EC L 207 of 18.08.2003), Corrigendum to Council Regulation (EC) No 1435/2003 of 22 July 2003 on the Statute for a European Cooperative Society (SCE).

²⁶⁾ Council Directive No. 2003/72/EC of 22 July 2003 supplementing the Statute for a European Cooperative Society with regard to the involvement of employees (O.J. EC L 207 of 18.08.2003).

²⁷⁾ Ustawa z 22 lipca 2006 roku o spółdzielni europejskiej (Dz. U. 2006, Nr 149, poz. 1077).

²⁸⁾ Ustawa z dnia 16 września 1982 roku Prawo spółdzielcze (Dz. U. 1982, Nr 30, poz. 210).

persons from at least two different member states are required. The minimum initial capital is 30,000 EUR, which is divided into the shares belonging to its founders (when the head office will be located in the member states not belonging to the Euro zone, a possibility to give the equivalent of that amount in the local currency is provided for). It possesses the legal personality. The Cooperative Society is subject to registration in one of the member states in which its head office is located. However, there is a possibility to relocate the seat without a necessity to liquidate it or re-register. It is included in the tax regulations of the country where its head office is. It is subject to the obligation of convening the General Assembly of Members at least once a year. Limited legal liability is its biggest advantage. The European Cooperative Society enables its members to carry out planned, often short-term or even one-time joint ventures, yet leaving full independence in any other ventures to its members. This organizational and legal frame is beneficial, among others, for groups of agricultural producers who want to expand their activity outside the borders of one country. It is also recommended to craftsmen, small producers, commercial firms or cooperative banks. Not only will already existing cooperatives be able to take advantage of this legal form, but first of all it will be for entrepreneurs who want to cooperate in order to achieve a common goal: entering new markets, or carrying out joint research.

European Private Company

The European Private Company (Latin *Societas Privata Europaea*, SPE)²⁹⁾ is supposed to be an equivalent of a private limited liability company and it is to be an adequate organizational and legal frame for small and medium-sized enterprises interested in undertaking activity in a few countries of the Community, mainly due to a low limit of the minimal founding capital which, according to the project, is to be 1 Euro, and the simplified registration procedures. The works on legislation in this scope are still in the consultation phase yet the form has a chance to be successful among entrepreneurs as its legal structure is to take into account the needs of small and medium-sized enterprises. The European Parliament resolution of 1 February 2007 emphasized the necessity to establish SPE as a legal form for small and medium-sized enterprises conducting cross-border activity³⁰⁾. The creation of SPE will be possible by one or more legal or natural persons who do not have to have the place of residence or a seat in a member state. At present, the requirements imposed on limited liability companies are totally different in each member state (e.g. in Germany a considerable initial capital is required, and in the United Kingdom such a company can be registered only by correspondence for GBP 100). In response to the standardization of this situation a European private company will be introduced. The company will obtain the legal personality on its registration. Both natural and legal persons will be able to establish it. Among the main advantages of its establishment, we should mention:

- regulation only in the Union directives, mandatory for all member states (differently than in case of a European company),
- the reduction of cost of setting up subsidiaries or branches in other member states by entrepreneurs from the member states,

²⁹⁾ German: *Europäische Privatgesellschaft*, French: *société privée européenne*, Polish: *europiej-ska spółka prywatna*.

³⁰⁾ European Parliament resolution with recommendations to the Commission on the European private company statute (2006/2013(INI)), Brussels, 1 February 2007. Document No. P6/TA(2007)0023.

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- better organizational transparency via the possibility to choose an internal organizational structure by the partners (the project does not plan obligatory bodies),
 - an easier registration process and the reduction of obligations related to information giving,
 - the reduction of bureaucratic actions and the costs of establishing and running the company.

The regulations of the national law with reference to this company will be applicable only in the accounting-fiscal and labour issues.

2.3. European Business Environment

Although European market place is a continually changing and evolving entity, but from the business point of view, the currently existing opportunities were barely imagined two decades or even a decade ago. The European business, which can be understood as any commercial activity in Europe, which operates across national boundaries. The European business is very heterogeneous as for³¹⁾:

- size structure (it includes micro, small, medium-sized and large enterprises,
- market scope (It can operate as a pure domestic business on local, regional on national area, but it can also operate, which is more and more popular, on European markets, as well as on non-European markets),
- sectoral focus (It operates in different sectors, some businesses offer a wide variety of service-oriented activities, some of European businesses produces goods and are classified as an industry sector and construction, and some of them are just agricultural enterprises),
- public or private ownership (Although private business is the dominant one, public organizations can be easily found in some sectors within the European Union, for example transport and the utilities),
- legal form (It can be run in any legal form available in any member state as well as in one of the so called Pan-European legal forms regulated in the EU law).

The European external environment creates opportunities and threats for European businesses, thus, before making a decision about the place of conducting activity, it is necessary to conduct a preliminary analysis of objective factors conditioning activity in individual member states. The factors worth considering are the ones concerning the condition of economy, the affluence of consumers, the conditions of establishing a company or the use of incentives for foreign investors.

The number of consumers and their affluence condition the right market. However, one should not forget that affluent consumers have bigger requirements, and products or services offered by entrepreneurs have to meet high quality standards and fulfil even some unconscious needs. In terms of affluence expressed in GDP per capita, calculated by the purchasing power parity, Luxembourg is the leader. The index in Luxembourg amounts to 228% of the average index for the whole extended Union. The index is higher than the average Union index in: Ireland, Belgium, Denmark, Austria, the Netherlands, Germany,

³¹⁾ Mercado S., Welford R., Prescott K.: *European Business*, 4th edition, Prentice Hall, Harlow 2001, pp. 2–9.

Finland, Sweden, France and the UK. The GDP per capita index for Spain is equal to the average index for the whole EU. The Lithuanian society is the poorest one – the index shows as little as 39% of the average Union index. The situation in Poland is just a little better (45.3%).

Starting-up Businesses³²⁾

The most popular form of conducting European-scale business activity mainly by foreign investors is a limited liability company. In order to establish a company in 2011 in the Community countries, 6 procedures are required on average. The minimum number is 2 in Slovenia, and maximum, 10, in Greece. The average time required to complete the registration procedure is almost 14 days in the Community, with the shortest time in Malta (2 days) as well as in Belgium and Hungary, 4 days, and the longest in Spain and in Poland where it is 28 and 32 days, respectively (Table 2.2).

The average cost of registration of a typical limited liability company in the European Union states is less than 500 euro, but in Denmark and Slovenia no fees are charged for a limited liability company registration. Moreover, the highest registration cost are incurred by entrepreneurs in Austria, Italy and Spain, and the lowest in the UK, the Netherlands and Sweden, and in majority of new member states of EU-12 (Lithuania, Hungary, Slovakia and Latvia and Estonia). Very interesting data illustrate not absolute costs but their percentage relation to the income of an average citizen of a given country. In 2011, the registration cost of a typical limited liability company in the European Union countries was, according to the World Bank, 5.0% of income per capita, and it was the highest in Greece (20.1%), Italy (18.2%), and in Poland (17.3%), and the lowest in Denmark and Slovenia (0.0%), as well as in Ireland (0.4%), Sweden (0.6%) and the UK (0.7%).

Also the amount of the minimum initial capital needed to start a limited liability company varies considerably in individual member states. The internal legislation of three member states (the UK, Ireland and France) does not specify the minimum initial capital for a limited liability company. It is determined in the company statute by the entrepreneurs, which means that in theory it may amount to the symbolic 1 euro. A very low level occurs in Estonia, Malta, Lithuania, Latvia, and in Spain, whereas it is very high in Austria. The requirements in Poland are below the Union average. On the other hand, presenting the relation of minimum initial capital to the income of an average citizen of a given country is very interesting. According to the specification prepared according to the World Bank, the situation in Austria (where the highest absolute minimum initial capital is in force, amounting to 35,000 euro), ranks least favourably in this classification (52.0%). A similar situation is in the Netherlands (50.4%). The best did Bulgaria, Cyprus, France, Ireland and the UK (0.0%). On average, this index is 15.9% of income per capita for all the EU countries.

³²⁾ Detailed analysis is available in the study: Wach K.: *Europeizacja małych i średnich przedsiębiorstw*, Wydawnictwo Uniwersytetu Ekonomicznego w Krakowie, Kraków 2008, pp. 68–85.

Table 2.2

Ease of Doing Business in the European Union Member States in the year 2011

Country	Ease of Doing Business – rank in the EU (in the world)	Starting a business				
		Rank in the EU (world)	Procedures (number)	Time (days)	Cost (% of income per capital)	Minimal capital (% of income per capital)
EU-26	–	–	5.6	13.7	5.0	15.9
Austria	14(32)	24(134)	8	28	5.2	52.0
Belgium	10(28)	8(36)	3	4	5.2	18.9
Bulgaria	21(59)	13(49)	4	18	1.5	0.0
Cyprus	16(40)	7(33)	6	8	13.1	0.0
Czech Republic	23(64)	26(138)	9	20	8.4	30.7
Denmark	1(5)	6(31)	4	6	0.0	25.0
Estonia	8(24)	11(44)	5	7	1.8	24.4
Finland	4(11)	9(39)	3	14	1.0	7.3
France	11(29)	3(25)	5	7	0.9	0.0
Germany	6(19)	20(98)	9	15	4.6	0.0
Greece	26(100)	25(135)	10	10	20.1	22.8
Hungary	20(51)	10(39)	4	4	7.6	9.7
Ireland	3(10)	1(13)	4	13	0.4	0.0
Italy	25(87)	17(77)	6	6	18.2	9.9
Latvia	7(21)	14(51)	4	16	2.6	0.0
Lithuania	9(27)	21(101)	6	22	2.8	35.3
Luxembourg	19(50)	19(81)	6	19	1.9	21.2
Malta	n/a	n/a	n/a	n/a	n/a	n/a
Netherlands	13(31)	18(79)	6	8	5.5	50.4
Poland	22(62)	22(126)	6	32	17.3	14.0
Portugal	12(30)	4(26)	5	5	2.3	0.0
Romania	24(72)	15(63)	6	14	3.0	0.8
Slovakia	18(48)	16(76)	6	18	1.8	20.9
Slovenia	15(37)	5(28)	2	6	0.0	43.6
Spain	17(44)	23(133)	10	28	4.7	13.2
Sweden	5(14)	12(46)	3	15	0.6	14.0
United Kingdom	2(7)	2(19)	6	13	0.7	0.0
Croatia	25*(80)	16*(67)	6	7	8.6	13.8

Source: own combination and calculations based on **Doing Business 2012**. *Doing Business in a More Transparent World*, World Bank – International Finance Corporation, Washington D.C. – November 2011.

Tax Competition in the European Union

The progressing process of economic integration on the European continent and the formation of the single European market bore fruit in the harmonization of the tax policy of the member states constituting the European Union in the scope of indirect taxes. Two latest extensions of the Community (in 2004 and 2007) provoked a discussion on the possible harmonization of direct taxes. In order to cope with the world competition, Europe must not only take into account its regional conditionings but first of all the worldwide tendencies, including also the ones in the fiscal policy.

The tax systems of the European Union countries influence further close integration of the Community. In recent years, majority of the member states have carried out the tax reforms, in some of them the process is in progress. The problem of taxes and their harmonization has great significance for the Union functioning since they are the basic source of budgetary revenues of the member states, and the European Union itself. The article constitutes a synthetic comparative analysis of the tax systems of all member states of the European Union, with the particular consideration to corporation tax.

The impact of taxes on the state of economy is obvious. To simplify, we may assume that the lower the taxes are, the faster the process of entrepreneurship development is, and, simultaneously, the increased economic growth, and vice versa, the higher the taxes are, the faster the process of deindustrialization of economy is, and what follows, the outflow of investment (capital and production) to countries with lower fiscal burdens. As a rule, low tax burdens of entrepreneurs foster investment of the profit made by them into further development of the company. Such a situation may create favourable conditions for the creation of new workplaces and is significant to foreign investors with reference to allocation of investments, especially direct ones (*green-field investments*). In order to strengthen this mechanism, some European countries apply minimum tax burdens only for the companies which decide on further investment of the profit made (e.g. Estonia). In some cases, low fiscal burdens of enterprises in a given country may, unfortunately, favour the phenomenon of reinvesting profits from the company activity to the country of its origin. Moreover, low fiscal burdens of natural persons may stimulate the development of entrepreneurship, and through it, the whole economy. It was experienced particularly by the Baltic countries, which, having introduced low personal income tax, observed considerable economic growth. However, it is worth emphasizing that low fiscal burdens of individual persons may foster mainly the increase in consumption, and not investment. In highly developed countries such a situation is not dangerous, as the population's consumption growth stimulates the growth of investment in the company sector, thus this solution also conduces creation of new workplaces. In developing countries the situation may be insignificant for the economic development. Also turnover taxes, mainly VAT, is important for entrepreneurs because it determines the level of final prices. Its low level conditions higher turnover of the companies, especially service ones. Such a situation may also lead to creating new workplaces. As it results from the aforementioned regularities, taxes have fundamental meaning in the competitiveness of a given country. Countries where high fiscal burdens are characteristic of the economy taxes may intensify the outflow of investments to the benefit of the countries where tax burdens are low.

In the Opinion of the Economic and Social Committee, the fiscal competition occurs on two levels³³⁾. The first of them constitutes the overall fiscal policy of a given country, which creates attractive conditions for conducting business activity than the ones occurring in the remaining countries. The key factors of this policy are: the tax scale and the principles of taxation. Regardless of the overall tax policy mandatory in a specific country, the other level concerns the introduction of extraordinary solutions, which frequently have a derogative character, in order to attract investors to a given country. This level of tax competition is obviously harmful.

European politicians, especially recently, raise issues related to tax competition. The opinion of the Economic and Social Committee of 28 February 2001 unambiguously states that the principles of company taxation, including the taxation base and the tax scale, directly influence the competitiveness of companies. The opinion distinguishes two levels of tax competition: the positive and the negative one, arguing that harmful tax competition is improper and should not be applied by the member states, emphasizing at the same time that each state has right to use their own tax policy. OECD also distinguishes harmful competition and carries out annual research in this scope³⁴⁾. Harmful tax competition is understood as activities of a specific country which introduce certain tax preferences for non-residents. One of the most obvious examples is Cyprus. By the end of 2002, Cyprus had very favourable legislation in the scope of taxation of foreign entities (off-shore companies) on the revenues on which the 4.25% tax rate was imposed.

A lot of member states aim at lowering tax rates in the scope of enterprise earnings and profit taxation, and therefore they disperse a worldwide stereotype of Europe as a continent characterizing with high fiscal burdens of entrepreneurs. However, it should be emphasized that tax competition exists not only in Europe but all over the world. Thus, it is hard to understand the postulates of these EU-15 countries in which tax burdens of entrepreneurs are very high. From the point of view of a European Union citizen who thinks most of all about the common good, it is unjustified to limit the freedom of the remaining European Union member states in the scope of determining the level of tax burdens. Lowering them is a thorn in some governments' side e.g. in France or Germany, but it results from two factors. Firstly, those states are net payers and they participate greatly in financing the whole Community. Moreover, the burdens on account of the social policy conducted in those countries are very high, which, without their radical reduction, prevents the tax reforms in those countries. According to the European Commission and Parliament, tax competition in Europe may be an effective instrument of the reduction of high level of taxation, arguing that as far as tax issues are concerned, the Union may only play the supplementary role to actions undertaken by the member states³⁵⁾.

At the current stage of the integration process, it is hard to talk about the tax system of the European Union, as in reality it consists of 27 national tax systems of the Community member states. At present, the EU does not possess the right to impose taxes, except for taxes on remunerations of the Union officials. However, taking into account further integration, the Community actions aim at the standardization of the national tax systems, at least

³³⁾ Opinion of the Economic and Social Committee of 28 February 2001 on Fiscal competition and its impact on company competitiveness, (O.J. EU C 149 of 21.06.2002).

³⁴⁾ For details see: Powell C.: *Harmful tax competition and the challenges for Jersey*, "Jersey Law Review" 1999, vol. 3, no. 1.

³⁵⁾ Ořeziak L.: *Finanse Unii Europejskiej*, Wydawnictwo Naukowe PWN, Warszawa 2004, p. 240.

to some extent. Yet, it is worth remembering that within the framework of 'the Community tax system' all decisions made in tax issues require the unanimity of the member states.

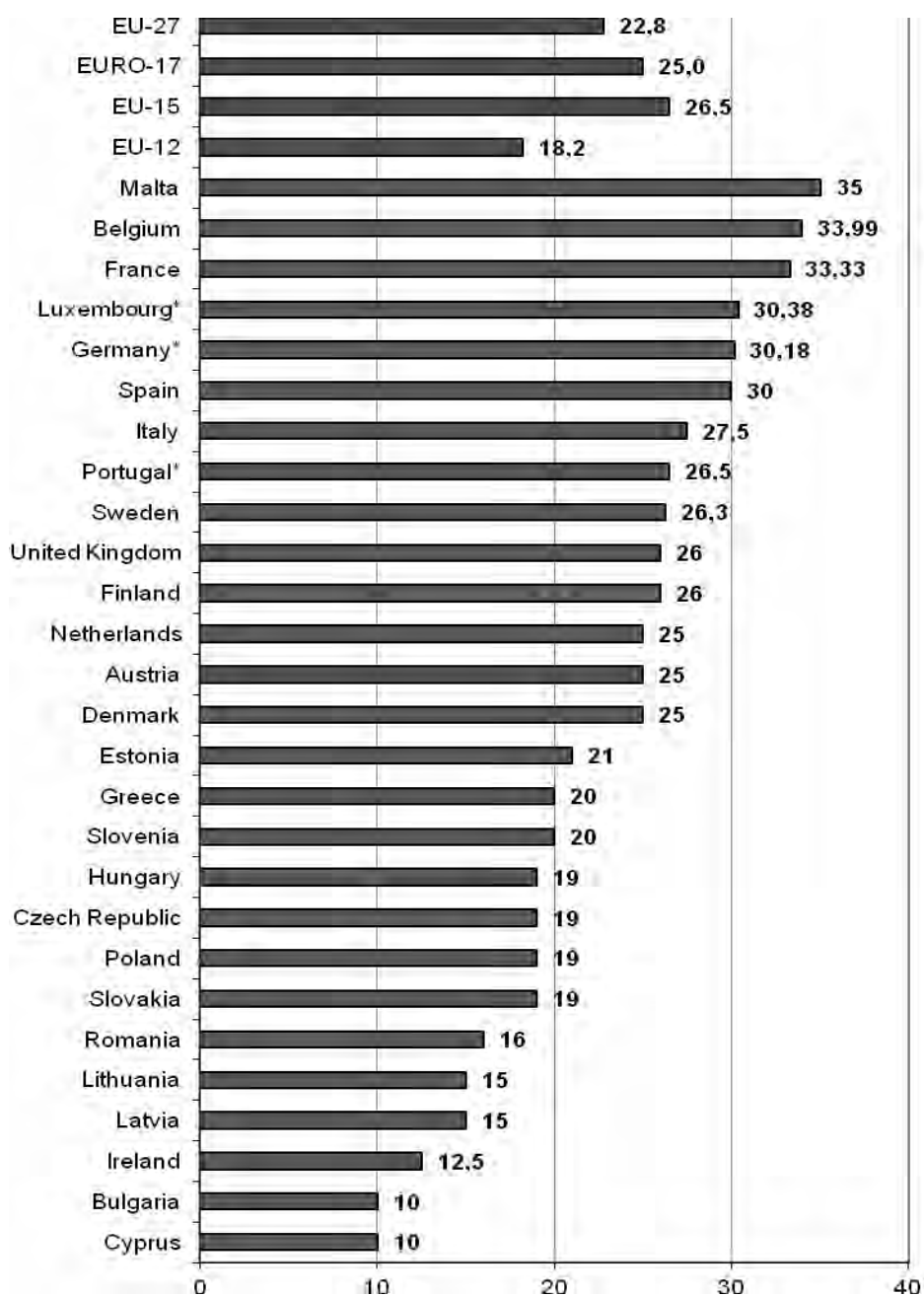
Corporate tax may take various forms. In majority of the European Union countries, there is corporation tax which is imposed on companies or companies possessing legal personality (sometimes, for example in Belgium, apart from the company tax, corporation tax is additionally levied, it is imposed only on some organizational and legal forms and is not identical with the corporate income tax occurring in Poland). In German-speaking countries, corporate income tax is levied, called similarly to the Polish tax. In Spain, Luxembourg, Germany, in Italy and in Hungary, company revenues are additionally taxed with the local tax on business activity (in Hungary it is possible to choose voluntarily a simplified income tax). In France, people doing liberal professions, pay the so-called professional tax instead of corporation tax. In some European Union countries also contribution taxes are paid on company revenues. It happens mostly in the countries where membership in the chamber of commerce is obligatory (for example, in Austria). Entrepreneurs may be also taxed on paid remunerations (payroll tax) – this tax, levied for example in Austria or Hungary, is a fiscal burden of entrepreneurs, imposed regardless of the social security contributions. Moreover, some countries have decided to introduce an additional crisis fee which increases the mandatory corporate tax rate, but only during a crisis. This tax occurs in Belgium or in France, among others. On the other hand, in Germany the tax is increased by so-called solidarity sub-charge which is allocated to equalize disproportions between the eastern and the western lands.

To sum up, the company gains in individual member states of the European Union are taxed variously. In eight countries, the corporation tax (regardless of their legal status) is levied, and in the other ones, for example in Poland, corporate income tax and personal income tax are applied. In some countries income is also subject to special forms of taxation. For example, Belgium and in Germany additionally impose the so-called special contribution which increases the basic tax rate (the height of the crisis contribution in Belgium is 3% of the base rate value, and the solidarity contribution in Germany is 5.5% of the base rate). In some countries other forms of company income tax are used (e.g. a temporary social tax in Lithuania, tourism and innovation tax in Hungary).

Comparing only base rates is unjustified since it does not show the totality of tax burdens on enterprise income, therefore this paper considers all tax burdens imposed on enterprise income. Individual names of tax on company revenues, profits of companies or legal persons are used interchangeably only for the needs of this paper.

The average level of corporate tax in twenty-seven countries of the European Union is 23% (Figure 2.2). The lowest tax burdens on company income occur in Cyprus (10%), in Bulgaria (10%) and Ireland (12.5%), whereas the highest are in Malta (35%), in Belgium (33.99%) and in France (33.33%).

A regularity may be observed, namely in the new member states of EU-12, the rates of taxes on company revenues are much higher than in the older member states, although also in this respect there are exceptions (e.g. Malta, Ireland).



Notes: * Rates also include local taxes on economic activities and other charges of the company income.

Fig. 2.2. Maximum Rates of Corporate Tax in the Member States of the EU in 2011 (in %)

Source: own study based on „Taxes in Europe”, http://ec.europa.eu/taxation_customs/taxinv (access: 02.12.2011)

When analysing tax systems of 27 member states, we should say that in twenty countries, including Poland, there is “clear” flat corporate tax rate, whereas in the other seven countries, the implied flat rate is used in connection with the supplement rate or preference rates for small and medium-sized enterprises.

It should be stressed that nominal tax rates are much lower in reality as entrepreneurs may take advantage of numerous investment tax incentives which are varied in individual European Union countries. International comparative studies commissioned by OECD and carried out in late 1990s on a sample of 2118 companies from the former EU-15 countries showed that the effective corporate tax rate in the years 1990–1996 differed by ten percentage points from the nominal one (even among countries which used identical or similar nominal rate). The effective rate was almost by half lower than the nominal rate in Belgium, Portugal and Austria, whereas insignificant deviations were observed in Sweden, France, the Netherlands, the UK and Finland.

The enlargement of the European Union in 2004 with Central and Eastern European countries, but also in 2007 with East-South European Countries, has become a strong impulse to intensify competition in the area of the taxation of company revenues in its framework³⁶⁾. The amount of the total tax burdens in the new member states in relation to GDP is lower by a few percentage points than in the EU-15 countries. Even bigger differences may be observed in the height of the nominal corporate tax rates (in 2009, the averaged rate for EU-15 was 27.2%, and in EU-12 only 16.8%, whereas in 2010 it was respectively 26.8% and 18.30%). Additionally, in three new member states (Lithuania, Latvia, Romania) there are tax preferences for small and medium-sized enterprises in the scope of taxation on general terms (see: Table 5). In addition, some countries apply tax preference in the form of simplified forms of taxation. For example, in Hungary there is a simplified EVA tax defined by flat rate to the amount of 15% which comprises both the income taxation and automatically releases from collecting and passing VAT to the revenue office. The simplified forms of taxation occur also in Poland (namely, flat-rate), and these are fixed amount (the so-called lump-sum) and tax on recorded revenue without deductible costs.

In order to study the relation between the amount of corporate tax rates and the GDP growth, the Pearson product-moment correlation coefficient has been applied, with the use of the Statistica computer package. Statistical analyses were carried out for the data for two chosen years, namely for the years 2005 and 2007. Statistical calculations showed statistically significant negative correlation between the analyzed variables (for 2007: $r = -0.62$ at $p < 0.01$ and for 2005: $r = -0.78$ at $p < 0.01$). That proves the correlation that the higher the corporate tax rates are, the lower the GDP growth rate is³⁷⁾. Low tax burdens of entrepreneurs not only create good climate for entrepreneurship development, but they also contribute to the economic growth.

Statistical calculations enable to adopt a hypothesis that the lower the fiscal burdens are, the higher the economic growth rate is. However, it should be emphasized that over the

³⁶⁾ Oręziak L.: *Konkurencja podatkowa i harmonizacja podatkowa w ramach Unii Europejskiej. Implikacje dla Polski*, Wyższa Szkoła Handlu i Prawa w Warszawie, Warszawa 2007, p. 204.

³⁷⁾ Detailed analyses are available in the study: Wach K., *Fiskalne uwarunkowania rozwoju przedsiębiorczości w krajach Unii Europejskiej ze szczególnym uwzględnieniem nowych krajów członkowskich* (rozdział 3) published in: *Rozwój przedsiębiorczości w nowych krajach członkowskich Unii Europejskiej*, ed. Targalski J., Wydawnictwo Uniwersytetu Ekonomicznego w Krakowie, Kraków 2010, pp. 57–76.

last two, three years fiscal burdens have been lowered in many EU-15 countries, and the calculations for 2007 in comparison with 2005 are a little weaker, which results from the fact that tax rates are still high in those countries, however, the GDP growth rate has definitely increased.

European Business Environment from a Comparative Perspective

Considering the aforementioned criteria, Cyprus may become a beneficial location, mainly due to very low taxes and investment attractiveness of that country. With regard to the amount of taxes, Estonia is also an attractive country, where a company investing its revenues in its own development is released from the income tax. Ireland attracts investors, too with low corporate taxes. On the other hand, the geographical closeness of the German market is a stimulator of delocalization of Polish enterprises. Corporate tax in that country is established on a very high level in comparison with other Western European countries. Low taxes, fast economic development of the state, minimum initial capital not defined by law, the lack of bureaucratic barriers and the full access to the labour market speak for the localization of a company in Ireland. It is similar in the UK: no minimum capital required by law, simple registration procedure, and as little as 20 GBP and 15 minutes are enough to register a company. In Sweden, it is relatively easy to establish a company mainly due to the lack of additional formalities and full openness of the labour market. Unfortunately, the cost of maintenance is among the highest in Europe. High taxes may also discourage. Registration formalities in Portugal are basically limited to minimum, yet geographical distance and low development rate of this country, as well as language barrier discourage many potential investors. On the other hand, according to advisors, firms of tourism industry may become successful in that market. In recent years, Spain has been a country which interests Polish entrepreneurs. The market of services is open to Polish people there. However, when employing workers delegated from Poland, the Spanish labour code must be observed, which is unfavourable for employers.

However, it should be stressed that in spite of unfavourable assessment of the above factors, it may turn out that having gone through bureaucratic registration procedures and having incurred initial costs, the decision on entering a given market may prove to be beneficial due to the aforementioned factors concerning a specific enterprise. One may also come across the opposite situation, when in spite of the favourable assessment of registration procedures and overall conditions of conducting business activity, it may turn out that our product and/or service has not been accepted by the local community due to subjective factors. The choice of a specific country depends on a number of factors, however, it should be made on the basis of a detailed analysis of the situation of a given entrepreneur and his capabilities.

Due to the maturity of the markets of individual countries, especially of the previous EU-15 to date, one must think it over thoroughly and plan the strategy of expansion (Europeanization of an enterprise). The Union consumers are very demanding and products offered by an entrepreneur should be of the best quality. It all depends on a given market and consumers.

Internationalization Strategies for SMEs

3.1. Internationalization Strategy and Its Typologies

A coin *strategy* is diversely defined. In the subject literature there are at least a couple of definitional trends. Krupski classifies three trends¹⁾. The first one focuses on the content and goals. The second definitional trend focuses on a substantive differentiator from competitors and/or business environment. The third trend understands a strategy as a way of behaving. Wickham points out also three definitional trends, but differently, namely: a content of a business strategy, a strategy adopting process and a strategy environmental context²⁾. We can assume that all definitions have some elements in common. Most of definitions focus on the content of a plan including goals, methods and means needed to realize the strategy³⁾. In this context, Dess and Miller distinguish between an *intended strategy* and a *realized strategy*⁴⁾. An intended strategy focuses on future, consists of goals, policies and plans and is proposed and designed by managers. A realized strategy references the past being a combination of intended and emergent components as an original strategy almost always changes several times throughout its implementation⁵⁾.

Any foreign market entry requires to apply an international strategy (internationalization strategy), that is a strategy considering foreign factors. Eden, Dai and Li while explaining the term *international strategy*⁶⁾, instead of giving the precise definition, they show the relations among international management (IM), international business (IB) and international strategy (IS) and conclude that the international strategy reflects the same domains as the field of international strategic management (fig. 3.1). The fields of IS deals with “the major intended and emergent initiatives, including cross-border initiative, taken by general managers on behalf of owners, involving utilization of domestic and/or foreign resources to enhance the performance of forms in the international environment”⁷⁾.

¹⁾ Krupski R.: *Istota strategii przedsiębiorstwa* (1.1.) In: *Zarządzanie strategiczne. Koncepcje – metody*, ed. Krupski R., Wydawnictwo Akademii Ekonomicznej we Wrocławiu, Wrocław 2003, p. 14.

²⁾ Wickham Ph.: *Strategic Entrepreneurship*, Pearson Education, Harlow 2006, p. 349.

³⁾ Ackoff R.L.: *Redesigning the Future*, John Wiley, New York 1974, p. 29.

⁴⁾ Dess G.G., Miller A.: *Strategic Management*, McGraw-Hill Inc., New York 1993, pp. 5–8.

⁵⁾ Mintzberg H., Waters J.A.: *Of Strategies, Deliberate and Emergent*, „Strategic Management Journal” 1985, no. 6, pp. 257–272.

⁶⁾ Eden L., Dai L., Li D.: *International Business, International Management, and International Strategy. What's in a Name?*, „International Studies of Management and Organisation”, Winter 2010–2011, vol. 40, no. 5, pp. 54–68.

⁷⁾ *Ibidem*, p. 61.

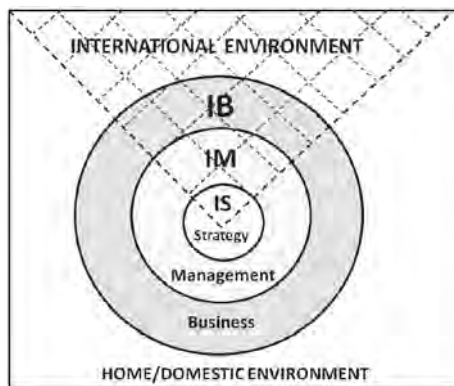


Fig. 3.1. The Context of International Strategy and Its Relations

Source: Eden L., Dai L., Li D.: *International Business, International Management, and International Strategy. What's in a Name?*, „International Studies of Management and Organisation”, Winter 2010–2011, vol. 40, no. 5, pp. 63.

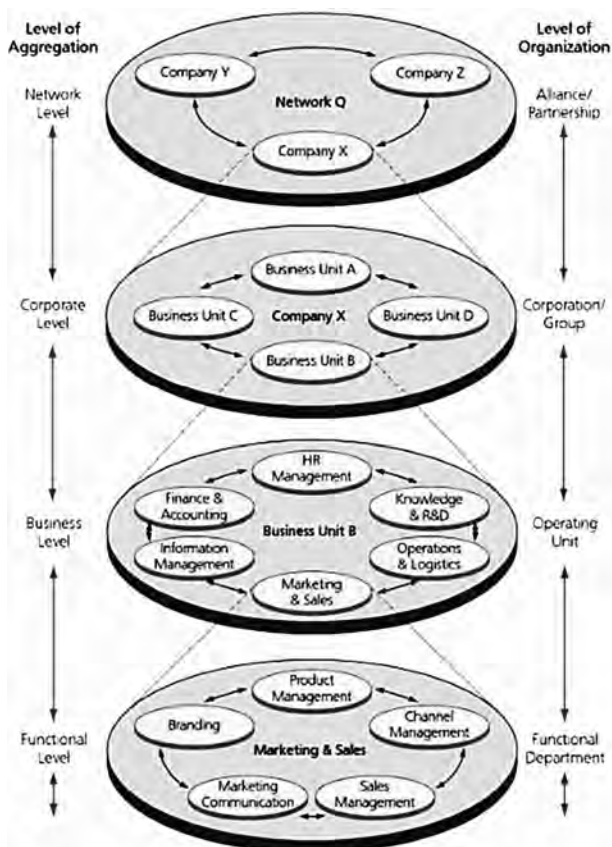


Fig. 3.2. Levels of Strategy

Source: de Wit B., Meyer R.: *Strategy. Process, Content, Context. An International Perspective*, 4th edition, Cengage Learning, Andover 2010, p. 9.

De Wit and Meyer suggest, that the strategy in an international perspective has four levels (fig. 3.2)⁸⁾:

- **functional level** including different operational aspects of a firm,
- **business level** concerning a separate group of products and/or services offered by a firm,
- **corporate level** concerning all groups of products and/or services offered by a multi business firm,
- **network level**, that is the strategy of the whole group of cooperative firms.

There are many classifications of internationalization strategies taking different dimensions and configurations into consideration. Furthermore, we will focus on five most popular typologies including concentration/diversification strategies and international orientation strategies, which date back to 1970s, nevertheless they are still the most often quoted in academic textbooks (table 3.1).

Table 3.1

Selected Typologies of Internationalization Strategies

Author	Typology
I. Ayal & J. Zif (1978)	1) market diversification strategy 2) market concentration strategy
M.E. Porter (1980)	1) cost leadership strategy 2) differentiation strategy 3) focus strategy
H.J. Ansoff (1965)	1) market penetration strategy 2) market development strategy 3) product development strategy 4) diversification strategy
A. Heenan & H.V. Perlmutter (1979)	1) ethnocentric strategy 2) polycentric strategy 3) geocentric strategy 4) regiocentric strategy
M.E. Porter (1985)	1) offensive strategy 2) defensive strategy

Source: own study

Geographical Concentration/Diversification Strategies

One of the typologies, made by Ayal and Zif⁹⁾, distinguishes two major strategic alternatives of market expansion, that is market diversification or market concentration (fig. 3.3). The **strategy of market diversification**, sometimes referred to as a convex strategy, applies a fast rate of growth in the number of market served at the early stages of expansion, however in the long run, the reduction in the number of markets will be noted as a re-

⁸⁾ de Wit B., Meyer R.: *Strategy. Process, Content, Context. An International Perspective*, 4th edition, Cengage Learning, Andover 2010, p. 8–10.

⁹⁾ Ayal I., Zif J.: *Competitive Market Choice Strategies in Multinational Marketing*, „Columbia Journal of World Business” 1978, vol. 13, no. 3, pp. 72–73.

sult of quitting less profitable markets. Market diversification is advised in segments, where logistic costs are relatively high or there is a need for product adaptation. A **strategy of market concentration**, sometimes refers as a concave strategy, applies a slow and gradual rate of growth in the number of market served at the early stage. Market concentration enables to reach economies of scales and is beneficial for reducing logistic costs.

The concept of concentration/diversification can be adopted to both – countries and segments, resulting in four different alternatives, namely:

- 1) dual concentration,
- 2) market concentration – segment diversification,
- 3) market diversification – segment concentration,
- 4) dual diversification.

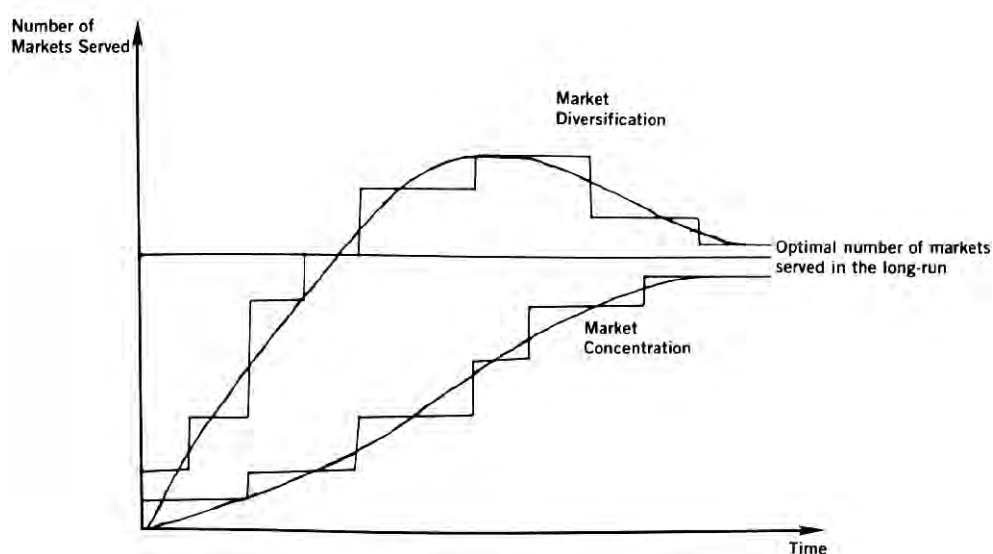


Fig. 3.3. Market Diversification vs. Market Concentration Expansion Strategies Over Time
 Source: Ayal I. , Zif J.: *Competitive Market Choice Strategies in Multinational Marketing*, „Columbia Journal of World Business” 1978, vol. 13, no. 3, p. 86.

The similar attitude to generic strategies was proposed by M.E. Porter. In his classification he distinguishes the following strategies (fig. 3.4)¹⁰⁾:

- **overall cost leadership** (a strategy based on a curve concept aiming to achieve overall cost leadership in an industry, so called low-cost position, through a set of functional policies),
- **differentiation** (a strategy, its numerous varieties, based on creating something that is perceived *industrywide* as being unique),
- **focus** (a strategy based on focusing a particular buyer group, segment of the product line, or geographic market, while there are two varieties that is differentiation focus and cost focus).

¹⁰⁾ Porter M.E.: *Competitive Strategy. Techniques for Analyzing Industries and Competitors*, The Free Press, New York 1980, pp. 35–41.

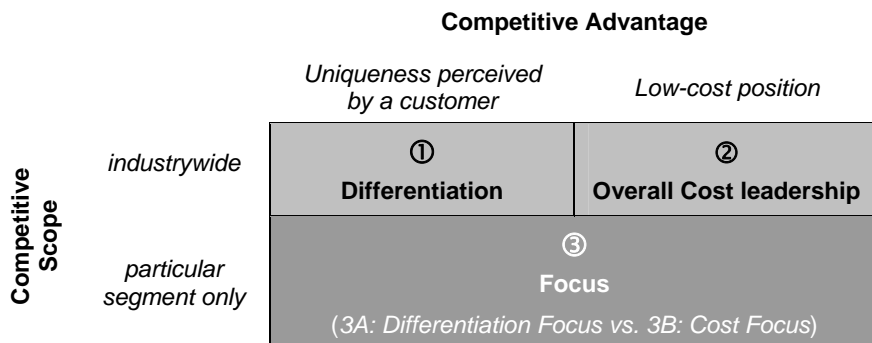


Fig. 3.4. Porter's Three Types of Generic Strategies

Source: Porter M.E.: *Competitive Strategy. Techniques for Analyzing Industries and Competitors*, The Free Press, New York 1980, p. 39.

Product-Market Expansion Grid

In mid 1960s, Ansoff proposed a kind of a strategy matrix using two variables – markets and producted, and their two dimensions – new and already existing ones (fig. 3.5). He distinguishes the following four strategies:

- **market penetration** (a strategy consisting in offering the existing products in the current markets),
- **market development** (a strategy consisting in developing and/or finding a new market for an existing product or products),
- **product development** (a strategy consisting in developing or modifying products and offering them in the existing markets),
- **diversification** (a strategy consisting in the development of new products in the new markets).

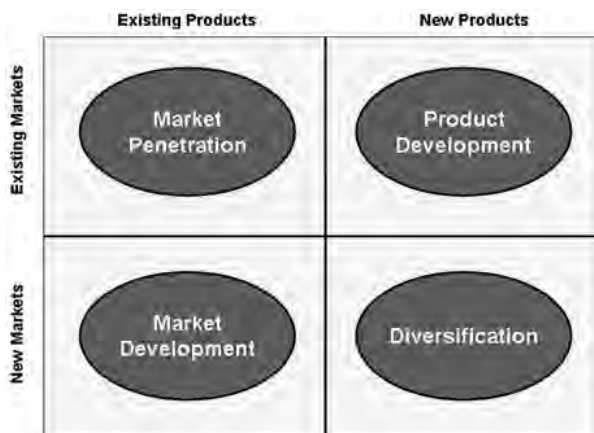


Fig. 3.4. Ansoff's Product-Market Matrix

Source: Ansoff H.J.: *Corporate Strategy. An Analytic Approach to Business Policy for Growth and Expansion*, McGraw-Hill, New York 1965, p. 109.

International Orientation Strategies

The strategy typology in terms of the degree of globalization involving the interplay between global integration and local responsiveness was suggested by Heenan and Perlmutter¹¹⁾. The following strategies may be mentioned as possible strategic orientations (fig. 3.5): ethnocentric strategy, polycentric strategy, geocentric strategy and regiocentric strategy.

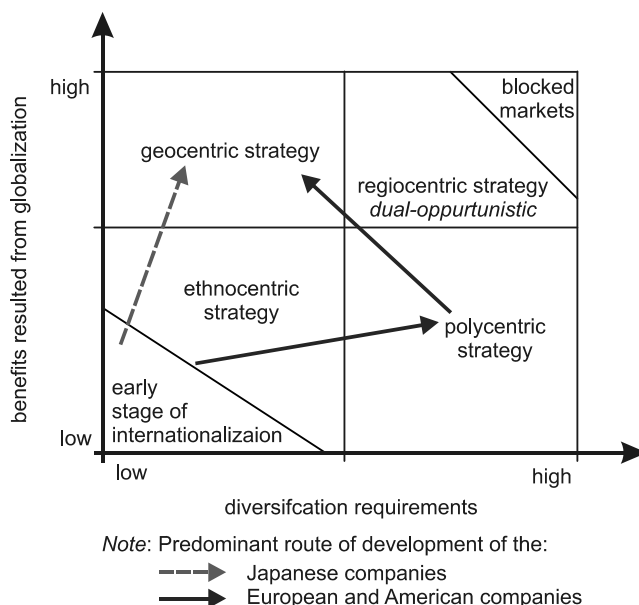


Fig. 3.5. The Typology of International Orientation Strategies

Source: Sznajder A.: *Strategie marketingowe na rynku międzynarodowym*, Wydawnictwo Naukowe PWN, Warszawa 1992, p. 99; Rymarczyk J.: *Internacjonalizacja i globalizacja przedsiębiorstwa*, Polskie Wydawnictwo Ekonomiczne, Warszawa 2004, p. 82.

Ethnocentric Strategy

An ethnocentric strategy is found mainly in the early stages of the internationalization of enterprises. Business activities are subordinated primarily to maintain the position on the domestic market, but it also uses the possibility of concluding effective international transactions¹²⁾. Enterprises using the ethnocentric strategy conclude mainly export transactions. This strategy is based on an analysis of foreign markets, such a selection, and the choice of market segments to enter the market gaps. A typical feature of this marketing strategy is a limited possibility of including, by a company, specific characteristics of different foreign markets. Enterprises using the ethnocentric strategy neither make large benefits from local activities, nor achieve benefits from a standardization or global strategy. Its concept is to

¹¹⁾ Heenan D.A., Perlmutter H.V.: *Multinational Organizational Development: A Social Architectural Approach*, Addison-Wesley, Reading, MA 1979 quoted in: Caligiuri P.M., Stroh L.K., *Multinational Corporation Management Strategies and International Human Resources Practices: Bringing IHRM to the Bottom Line*, "International Journal of Human Resource Management" 1995, vol. 6, no. 3, p. 495.

¹²⁾ Sznajder A.: *Strategie marketingowe na rynku międzynarodowym*, Wydawnictwo Naukowe PWN, Warszawa 1992, p. 100.

reach abroad the competitive advantage, previously gained on the domestic market¹³. Companies are focused on maintaining the national market position and gain foreign markets following the same strategy as the domestic market, as already mentioned most often in the form of a simple export. Ethnocentrically oriented companies are not able to adjust their marketing activities to specific foreign markets, the primary market for the companies using this strategy is a national or regional market¹⁴.

Polycentric Strategy

The next stage in the process of arriving at the global strategy is the polycentric strategy¹⁵. This strategy takes account of specific features of host or local markets. Therefore It uses benefits of their local activities. The aim of the company polycentric strategy is to ensure the success in many regional markets, where these companies have their regional subsidiaries¹⁶. One of the basic features of the polycentric strategy is the decentralization reflected in the development of overseas subsidiaries, manufacturing plants and joint ventures. The polycentric orientation has developed strongly in recent years due to the rise of multinational enterprises, which focus their strategic activity on many host markets¹⁷. Independent goals, strategies and marketing mix instruments are formulated and developed for each particular market separately. This orientation does not have a high degree of standardization of levels of the marketing concept, but the degree of markets differentiation is very high.

Geocentric Strategy

Moving from the polycentric strategy to a global one is the adoption of the geocentric orientation, which means that a specific region of the world or the world is treated as essentially a single, identical market. The aim of such a strategy is to improve international competitiveness, thanks to making the uniform system of all company's activities¹⁸. The desire to obtain a competitive advantage on a global scale by minimizing the unit cost of production is fundamental for this strategy. Mass production of standardized products enables to achieve economies of scale. Geocentric orientation is to use a standardized marketing concept in all countries, and marks a new direction of the competitive struggle, which aims to strengthen the international competitive activity, primarily by large corporations¹⁹. This orientation is characterized by high standardization and very low differentiation at all levels of the marketing concept²⁰.

Regiocentric Strategy

The regiocentric strategy, also known as the individual or dual strategy, can be mentioned in addition to the basic three strategies described above. The regiocentric orientation

¹³ Rymarczyk J.: *Internacjonalizacja i globalizacja przedsiębiorstwa*, Polskie Wydawnictwo Ekonomiczne, Warszawa 2004, p. 82.

¹⁴ Komor M.: *Euromarketing. Strategie marketingowe przedsiębiorstw na eurorynku*, Wydawnictwo Naukowe PWN, Warszawa 2000, p. 20.

¹⁵ Sznajder A.: *op. cit.*, p. 100.

¹⁶ *Ibidem*, s. 100.

¹⁷ Komor M.: *op. cit.*, p. 21.

¹⁸ Sznajder A.: *op. cit.*, p. 100.

¹⁹ Komor M.: *op. cit.*, p. 21.

²⁰ Wach K.: *Strategia globalizacji jako jeden z efektów walki konkurencyjnej przedsiębiorstw*, „Zeszyty Naukowe Akademii Ekonomicznej w Krakowie”, nr 622 (2003), p. 133.

involves combining homogeneous groups of foreign markets and treating them as one market. The Eurocentric orientation is a very specific form of the regiocentric orientation. This approach is tailored to the European Single Market and allows you to apply fully the concept of Euromarketing²¹⁾. Striving to achieve benefits from global integration and the need to adapt to local conditions is fundamental to the dual strategy²²⁾. The compulsion of local adaptation is most often the result of protectionist measures taken by host countries.

Offensive and Defensive Competitive Strategies

In mid 1980s M.E. Porter differed between an offensive and defensive strategy²³⁾. A **defensive strategy** (a passive strategy or a reactive strategy) focuses on the survival and minimizing risks. It is a kind of protecting a firm's existing position. An **offensive strategy** (an active strategy or an expansive strategy, or an aggressive strategy, or a prospective strategy) results in the development and expansion. It focuses both on the penetration of existing markets and entering new markets. It attempts to enhance the competitive position of a firm by improving its performance²⁴⁾.

3.2. Structure and Implementation of Internationalization Strategy

The market expansion strategy of a business includes a number of behaviours ranging from simple foreign trade transactions to take independent production activities in a given country with the necessary configuration elements in the international business, international management and international marketing

The international or internationalization strategy, that is the market expansion strategy requires two main steps to be prepared, that is the diagnosis of goals and resources determination as well as the product and market analysis (fig. 3.6).

Prior to the decision to enter a specific target market, at least preliminary market research should be conducted, but most importantly, the strategy for internationalization of the company, which reflects the company's behaviour plan towards the foreign environment should be also formulated. Forming of the recommended strategy for internationalization of the company comprises of three main phases, which are both consecutive and iterative (fig. 3.7):

- 1) to research and analyse a target host market,
- 2) to formulate a detailed expansion strategy,
- 3) to implement the strategy and then its control.

These three stages are preceded by strategic analysis of a business unit's potential including its resources and goals.

²¹⁾ Komor M.: *op. cit.*, p. 20.

²²⁾ Rymarczyk J.: *op. cit.*, p. 82.

²³⁾ Porter M.E.: *Competitive Advantage. Creating and Sustaining Superior Performance*, The Free Press, New York 1985, pp. 445–537.

²⁴⁾ Sahaf M.A.: *Strategic Marketing. Making Decisions for Strategic Advantage*, Prentice Hall, New Delhi 2008, p. 202.

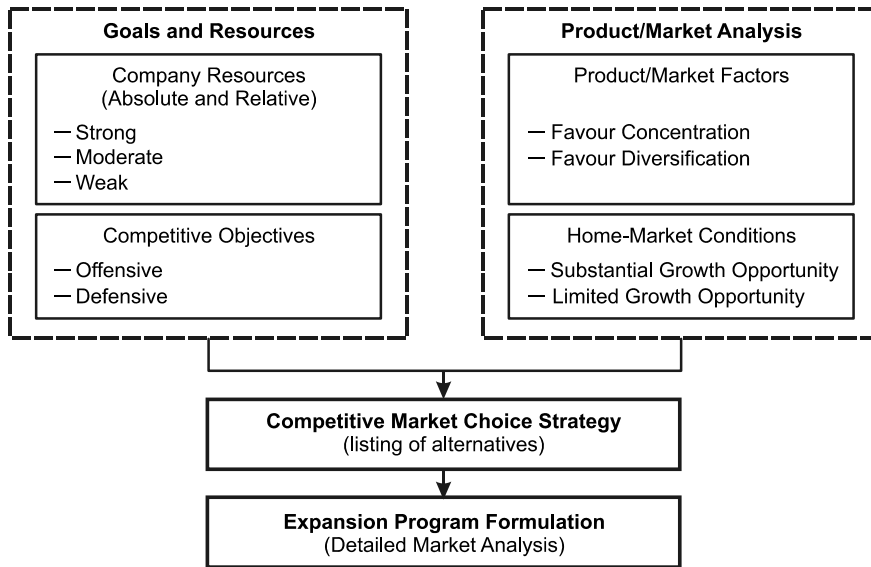


Fig. 3.6. Competitive Market Choice Strategy Formulation Process

Source: Ayal I., Zif J.: *Competitive Market Choice Strategies in Multinational Marketing*, „Columbia Journal of World Business” 1978, vol. 13, no. 3, p. 74

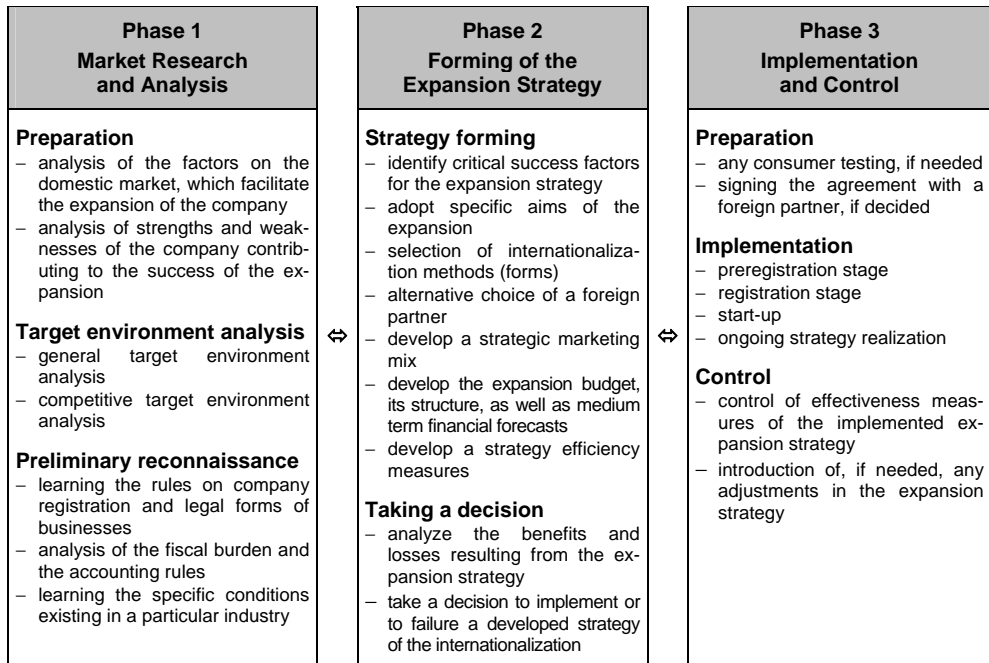


Fig. 3.7. The Framework Phases for Market Expansion Strategy

Source: own study

Phase 1: Market Research and Analysis

In de Wit's and Meyer's view there are four levels of a international strategy context, that is a manager, organizational context (internal environment), industry context (competitive environment, task environment, microenvironment) and international context (general environment, macroenvironment)²⁵⁾.

Operating rules of the whole economy and businesses of the target localization determine the opportunities to achieve success on the particular foreign market. The first step in understanding the conditions under which the company will operate on a foreign market is the general environment scanning and analysing. The PEST analysis (*Political, Economic, Social, Technological*) is frequently used for this purpose. It is a good starting point to use a much more sophisticated methods of analysis (figure 3.8)²⁶⁾. The integration of legal factors into the PEST analysis makes its variation – the SLEPT analysis, and further addition of ecological factors – the PESTLE analysis. Occasionally the PLESCET analysis can be conducted, in which seven dimensions are analyzed (*Political, Legal, Economic, Social, Cultural, Ecological and Technological*).

Political Factors	Economic Factors
stability of policy, rules for business running, antitrust and cartel law, competition and consumer protection, labour law, environmental protection law	unemployment rate, inflation rate, relative and absolute increase in GDP, the size of domestic demand, interest rates, exchange rates, the availability of credits and investment incentives, tax burdens, the level of customs duties, income levels of society, the balance of trade and payments, foreign sales, production costs
PEST Analysis of General Environment (Target Country Variables for Entry Mode and International Strategy Choice)	
Socio-Cultural Factors	Technological Factors
level of education, social mobility, consumer environmental awareness, values, lifestyle, religion, work ethics, the attitude of society to foreign products and companies, labour productivity	level of expenditure on research and development, information and communication technologies, the index of competitiveness and innovation, the degree of computerization

Fig. 3.8. Selected Analytical Criteria for General Environment

Source: Own study

The competitive environment analysis (e.g. using M.E. Porter's five forces method, strategic group map, or industry attractiveness scoring) is a kind of much more detailed analytical tool. In fact, each company operates in a particular industry, in which some specific regulations exist, but more importantly all the specific conditions for the competition apply (fig. 3.9). These are industries that are highly concentrated, and the new entries require considerable capital expenditure, and often collaboration with a local partner.

²⁵⁾ de Wit B., Meyer R.: *Strategy. Process, Content, Context. An International Perspective*, 4th edition, Cengage Learning, Andover 2010, p. 11.

²⁶⁾ Johnson G., Scholes K.: *Exploring Corporate Strategy*, Prentice Hall Europe, London 1999, p. 104.

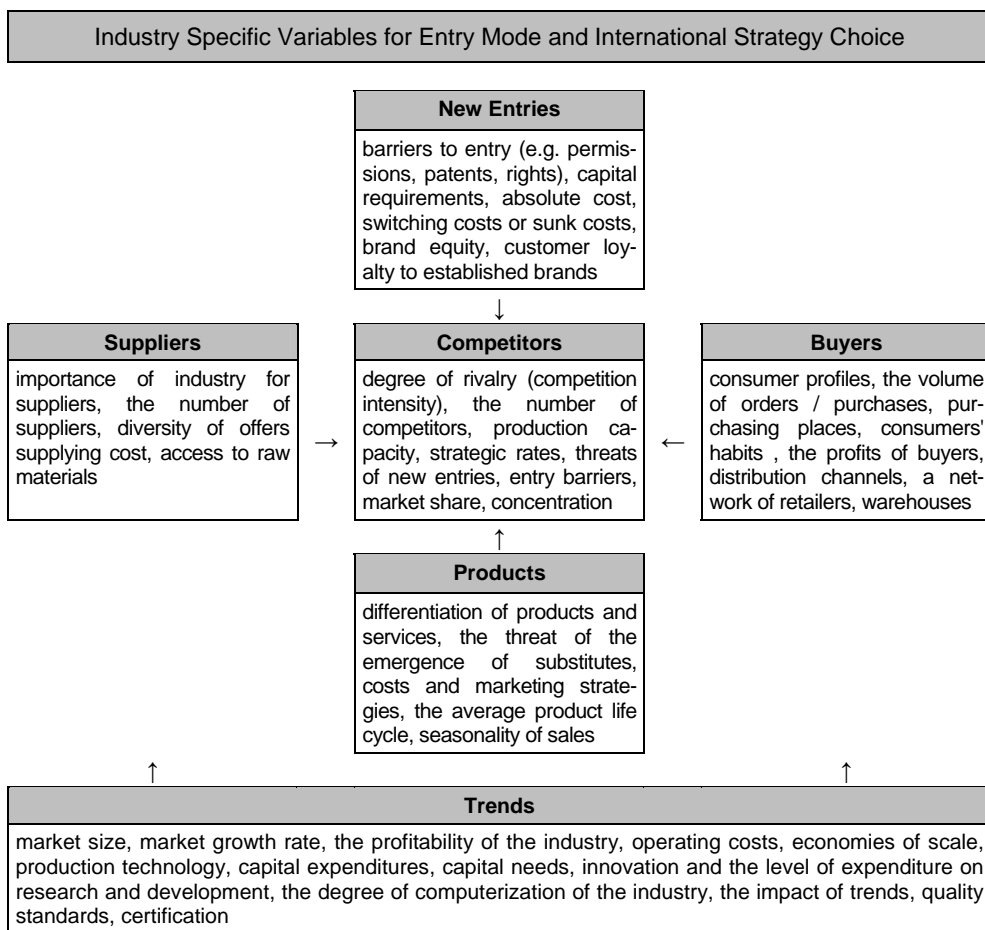


Fig. 3.9. Selected Analytical Criteria for Competitive Environment Porter's 5F Analysis

Source: Own study based on Porter M.E.: *Competitive Strategy. Techniques for Analyzing Industries and Competitors*, The Free Press, New York 1980.

After the initial recognizing of the situation prevailing in a given industry it is advisable to choose a number of competitors (preferably strategic ones) and conduct a comparative analysis of the company competitors (*benchmarking*). On this basis, one can determine their own competitive position in a particular foreign market.

Preliminary reconnaissance, and particularly consulting with specialists, including a lawyer, a notary, a tax adviser or an accountant is a valuable enrichment to continue the building process of the internationalization strategy of the company. A visit to one of the local chambers of commerce or crafts, especially for those types of activities covered by specific regulations on the target market, is also recommended. When starting a business in particular countries one should be familiar with the basic rules and regulations in those countries, in which the start up is planned, among them:

- national regulations on the starting-up, registration and running businesses,
- national regulations on the organizational and legal forms of doing business in a given country,

- taxation system in a given country (including the amount and manners of payments of income taxes, asset taxes and turnover taxes, and in some cases even local taxes on business or any special taxes),
- social security system in a given country (including the ways of contributions payments, the amount and the share of the employer and employee),
- labour law issues in a given country (an appropriate number of weekly working time and holiday leave, minimum wage/salary and other working conditions).

Starting with a general overview of starts-up and business functioning conditions in a selected host country is recommended, then conducting a detailed analysis of the specific market segment (industry) should be followed. In the initial phase, one should look into the conditions of starting and running a business (registration costs, registration time, administrative restrictions, minimum capital, investment incentives, tax system, contact the notary, etc.).

Entrepreneurs wishing to expand their business abroad are challenged by the fact that business activities in a given country are governed by diverse internal regulations. It is so difficult to compare them because of the large and different number of administrative and legal details, but also the local habits. Very often the decisions about choosing the destination country are not only affected by legal business environment. The size and value of consumer market, geopolitical position, economic growth and development of a given country, incentives for foreign investors, the proximity of suppliers are important factors as well. In addition there are some basic and general factors which promote the establishment of companies in a given country (table 3.2):

- 1) transparency of the law governing the establishment and business activities in a host country,
- 2) conditions for business registration in a host country,
- 3) fiscal burdens in a host country,
- 4) employment conditions in a host country,
- 5) operating costs for economic activities in a host country,
- 6) localization advantages of a host country,
- 7) investment incentives offered by a host country.

Table 3.2

The General Justification Criteria for a Choice of a Localization

Assessment	Factors
Business law	<ul style="list-style-type: none"> – company law (legal forms regulations), – other regulation of businesses, – profits transfer including transfer pricing, – stability of laws and regulations, – competition and consumer protection rules
Registration conditions	<ul style="list-style-type: none"> – the time needed to register a company, – registration costs, – the costs of starting-up a company (notary, lawyer, translator), – the minimum amount of own contribution (share capital),
Fiscal burdens	<ul style="list-style-type: none"> – income tax for individuals (personal income tax, PIT), – corporate taxation (corporate income tax, CIT), – dividend tax and/or withholding tax, – value added tax (VAT) or any turnover tax, – any additional business taxation, – complexity and difficulty of accounting, – stability of the tax laws

Continued Table 3.2

Assessment	Factors
Hiring employees	<ul style="list-style-type: none"> – availability of well-qualified human resources, – labour law, – minimum and average wages/salaries, – additional labour costs incurred by an employer, – criteria for employing foreigners, – transitional periods (if any)
Operating costs	<ul style="list-style-type: none"> – economic consulting costs (a tax adviser, a notary, a legal adviser, a translator, an investment adviser), – accounting cost (an independent accountant or an accounting office), – rental costs and an office running costs
Localization advantages	<ul style="list-style-type: none"> – transport infrastructure, – telecommunications infrastructure, – geographical distance, – strategic localization, – availability of subcontractors and suppliers, – level of innovation and competitiveness of a given economy, – society's prosperity, – presence of the international business community, – level of bureaucracy in public administration, – membership of the euro zone or, exchange rates, – openness of the society, – the official language and foreign languages skills and abilities, – niche markets
Investment incentives	<ul style="list-style-type: none"> – incentives for start-ups, – special economic zones, – investment incentives and tax reliefs/deductions for foreign entities

Source: own study

Phase 2: Strategy Preparation

The next step is to develop a strategy for the entry onto the target market, taking into account *inter alia*:

- 1) the specific objectives the expansion, which can be both quantitative and qualitative
- 2) the choice of target market(s) and the definition of geographical concentration or diversification,
- 3) choice of a generic strategy for the whole business,
- 4) choice of a particular international strategy,
- 5) choice of entry mode into a selected market, which depends on many factors, including organization specific variables, marketing strategy variables, target country variables and industry specific variables²⁷⁾,
- 6) choice of a possible foreign partner, if any,
- 7) financial plan for the selected market, developed for the period until at least it reaches break-even point,
- 8) marketing plan on the selected target market(s),
- 9) measures of the effectiveness of the implementation of the intended strategy so that to enable the control of its implementation and make any adjustments (realized strategy).

²⁷⁾ Gannon M.: *Towards a Composite Theory of Foreign Market Entry Mode Choice: The Role of Marketing Strategy Variables*, „Journal of Strategic Management”, 1993, vol. 1, no. 1, p. 48.

Some studies show that the generic strategies have some impact on different internationalization strategies and business performance²⁸⁾. Thus, while preparing the international strategy, a business must assume a particular generic strategy, that is – in Porter's view – cost leadership strategy, differentiation strategy or focus (*niche*) strategy. In some cases a generic strategy impacts on a international strategy, but there is no simple evidence to prove such a correlation as some studies do not confirm it.

Cooperation with a foreign partner, is highly recommended as an option, it may greatly simplify the registration process and create solid foundations of a business on a foreign market in the first phase of its operation. Paying the attention to the marketing strategy is also very crucial, as in some countries, consumers are very attached to national products. Choosing the right model for foreign market commitment and involvement unlocks various competitive advantages, available to potential local partners. The most important potential benefits of such cooperation include:

- making use of the experience and market knowledge of the partner for the creation of an optimal strategy in the market (including marketing mix instruments),
- wide market access through the already-developed distribution channels and marketing potential of the partner,
- sharing of investment costs and associated risks, the possibility of the creation of new supplies, complementary to existing business lines or segments of the supply chain,
- access to complementary, to previously used technologies, resources and knowledge,
- the potential economies of scale.

Before making a decision of starting a business in a selected country or before transferring the headquarters, one should invest in some detailed initial analysis including an analysis of benefits and losses as well as checking legal conditions for the selected market. One must remember that the conditions in particular countries are varied and may turn into some disadvantages. An experienced and resourceful lawyer practicing in a particular host country should be recruited and acquired, mainly because of the language barrier, and in some cases because of bureaucracy and administrative complexities. With the help of such a lawyer, the entire process of setting up a company generally runs better and faster.

Phase 3: Implementation and Control

The last phase is to implement the planned or intended strategy and its monitoring as well as possible adjustments. One can distinguishes two successive stages of the start-up stage, namely:

- 1) pre-registration stage,
- 2) registration stage.

The formalities associated with particular starting up a business overseas vary greatly in particular countries. The pre-registration stage includes such activities as:

- legalization of stay (to obtain a residence card or a residence permit),
- collecting the required documents and their translations,

²⁸⁾ For example: Solberg C.A., Durrieu F.: *Access to Networks and Commitment to Internationalization as Precursors to Marketing Strategies in International Markets*, „Management International Review”, 2006, vol. 46, no. 1, pp. 57–83; Solberg C.A., Durrieu F.: *Strategy Development in International Markets: A Two Tier Approach*, „International Marketing Review”, 2008, vol. 25, no. 5, pp. 520–543.

- initial verification of the company name,
- preparing the notarial deed (memorandum of association, articles of association),
- submitting an initial capital into a bank account,
- obtaining required permits or licenses,
- establishing the cooperation with a foreign partner,
- conducting any consumer testing.

We must note that in this phase the entrepreneur has already incurred initial business start-up costs, including notary fees, and especially a lawyer.

The proper registration stage is regulated by the domestic law in particular countries. However, one can assume that it includes such activities as:

- the registration of a company (usually in the business register, in the case of an individual enterprise usually in the commune office or a tax Office / the inland revenue),
- the registration in a tax office (the inland revenue) for the purpose of income taxation (PIT, CIT) and VAT,
- the registration for the social security system and contributions,
- the membership in the Chamber of Commerce and Industry and/or Crafts (in some countries, membership in the Chamber is mandatory).

After the completion of all formalities, one can run the business. It is worth noting that the first period of activity is usually very difficult (like in your own country), and bureaucratic and linguistic barriers are a kind of additional difficulties.

3.3. Modes of Internationalization

The choice of modes (methods, forms, ways, instruments) of internationalization depends on both endogenous factors (e.g. the competitive potential of a firm) and exogenous ones characterizing the given target market. The choice of methods depends on some objective factors. Different forms of entry on foreign markets are characterized by different efficiency, but also different costs of entry. One can propose to systematize forms of entry describing intensity of internationalization taking their four degrees into account (tables 3.3 and 3.4).

The first level of internationalization of activities the company is synonymous with the sales internationalization (internationalization of the sphere of exchange), mainly through export and import activities. Such activities are associated with low risk. The businesses only carry out foreign orders as they receive them. In most cases this is the only form of businesses engaging (particularly SMEs) in international activities. This phase is a natural consequence of development. It occurs after a business reaches all its capabilities on the domestic market and achieves an appropriate volume of production as well as in some cases surplus production. Then the company seeks to expand its market and begins to export (push motives). The business may be also motivated to enter into foreign markets by the ability to make profits on these markets, as the business reaches more and more profits on the domestic market (pull motives). The business activities can take various forms, including: indirect export, direct export, indirect import, direct import, as well as other specific forms.

Table 3.3

Intensity, Range and Modes of Business Internationalization

Degree of Internationalization Intensity	Modes
0. Activity on domestic market	<ul style="list-style-type: none"> – domestic transactions – indirect import – direct import
1. Sale Internationalization	<ul style="list-style-type: none"> – indirect export – direct export – transit trade – barter trade – representative office
2. International Cooperation	<ul style="list-style-type: none"> – subcontracting – piggybacking – licensing of trade-marks – franchising – management contracts – turn-key operations – strategic alliances
3. Foreign Affiliates	<ul style="list-style-type: none"> – branch – subsidiaries <ul style="list-style-type: none"> • joint venture subsidiary • wholly-owned subsidiary
4. Business Globalization	<p>Above mentioned modes are used within the fourth strategies:</p> <ul style="list-style-type: none"> – international company – multinational company – transnational corporation – global firm

Source: own study

An advanced form of sales internationalization is a foreign representative office. The office can act as a salesman for foreign trade contracts (negotiating the terms of delivery and conducts market research, which is necessary for direct exports). National sales representative can be:

- an own employee of a business delegated abroad for a given period (working abroad only temporarily),
- an own local employee of a business (employed directly by the parent company abroad),
- a local partner business (representing only the interests of its principal, which is the parent business).

Such a representative office can take many forms, while traditional agencies are the most popular, however there are also marketing offices, technical offices, information offices and consultation offices.

The second level of intensity of internationalization business activity mainly implements cooperative relations by entering into contacts with foreign partners, mostly manufacturers. This phase includes international licensing, international franchising and international subcontracting, while the more advanced and sophisticated forms of cooperation focus on foreign capital (including joint operating with a foreign partner in a commercial business).

Higher degree of intensity of internationalization business activity means doing businesses abroad. At this stage, a business clearly operates onto foreign markets by opening:

- a foreign branch,
- a foreign subsidiary (including joint venture and wholly-owned subsidiaries).

Investments in branches and subsidiaries provide lower production costs and direct presence on foreign markets. Foreign Subsidiaries can be created in two ways: it can be done by acquiring a local company (brownfield investments) or an investment can be realized from the beginning (greenfield investments).

The most advanced degree of business internationalization intensity can be understood as business globalization (compare chapter 1). In this phase, the company is international and aims to consolidate all international operations. Relations between foreign affiliates and a parent company is very important in here. In this phase a business makes decisions on the centralization level of all its operations. At the central level, operations of production, distribution, or services that are standardized in the large markets, are coordinated. Business globalization can be defined as perceiving the world market as one (or even single) market for the business. The summary of the various modes of internationalization are shown in table 3.4.

Particular modes of internationalization are diverse in many respects, namely:

- scope of capital commitment,
- scope of management commitment,
- scope of control,
- scope of risk,
- scope of potential profits,
- scope of input costs.

One can easily observe some regularity. The higher the extent of management involvement is, the higher the scope of control and risk is. The increasing of invested capital involves the increasing of the management on foreign markets. The lower the entry costs are, the lower the profitability of carried out transactions are.

Table 3.4

Advantages and Disadvantages of Different Modes of Internationalization

Mode	Characteristics	Advantages	Disadvantages
Indirect Export	The sale of goods or services through the domestic intermediary	<ul style="list-style-type: none"> – low entry cost, – low financial risk, – entry difficulties are lied on the domestic intermediary, – low staffing requirements, – lack of marketing costs, – the least complicated mode of internationalization, – relatively simple extension of sales markets 	<ul style="list-style-type: none"> – low profitability of the transactions, – full dependence on the domestic intermediary, – lack of knowledge on the foreign market(s), – inability to gain international experience, – the domestic intermediary can find a better provider, – an intermediary may itself start the production in the country

Continued Table 3.4

Mode	Characteristics	Advantages	Disadvantages
Direct Export	Direct Export through a foreign agent (as a foreign intermediary)	<ul style="list-style-type: none"> – low entry cost, – moderate financial risk, – the agent overcomes the difficulties of entry, 	<ul style="list-style-type: none"> – low profitability of the transactions, – high dependence on the foreign agent, – inability to gain international experience,
	Direct Export through a foreign distributor (as a foreign intermediary)	<ul style="list-style-type: none"> – relatively low staffing requirements – lack of marketing costs 	<ul style="list-style-type: none"> – an agent can find a better provider – high transport costs – potential trade barriers
	Direct Export through a representative office	<ul style="list-style-type: none"> – physical presence on foreign markets, – direct contact with foreign Customer, – the permanent possibility to respond to foreign market signals 	<ul style="list-style-type: none"> – the relatively high costs of maintaining a representative office, – high transport costs, – potential trade barriers
	Direct Export through an own foreign distribution network	<ul style="list-style-type: none"> – physical presence on foreign markets, – very good direct contact with foreign customers, – full control over the sales process, – relatively high profitability compared with other forms of exporting 	<ul style="list-style-type: none"> – high entry cost, – high cost of maintaining the own distribution network, – time-consuming of building up the own distribution network
Cooperative export	Export grouping	<ul style="list-style-type: none"> – distribution of costs for partners, – synergy effect 	– dependency on the export partner(s)
	Piggybacking		
Management contracts	An exporter provides management services for a company that is owned by the importer	<ul style="list-style-type: none"> – low capital commitment, – low risk, – gaining experience on the foreign market(s) by domestic managers, – can be regarded as a "substitute" form of foreign market entry 	– relatively low profitability
Turn-key operations	Any complete construction of any industrial plant abroad	<ul style="list-style-type: none"> – potential higher profits, – chance of a permanent presence on the foreign market(s) after the completion of the investment, – ability to earn returns from technologies in countries where FDI is restricted 	<ul style="list-style-type: none"> – require high costs, – a form difficult to implement, – high financial risks
Subcontracting	The foreign counterparty shall have a domestic manufacturing company to execute a specific order (components or semi-finished products)	<ul style="list-style-type: none"> – low capital commitment, – low risk 	<ul style="list-style-type: none"> – relatively low profitability, – inability to gain international experience, – weak position of the exporter in negotiations with the consignee

Continued Table 3.4

Mode	Characteristics	Advantages	Disadvantages
Licensing	Sales abroad of rights covered by a patent or design or any intellectual property to be used for commercial purposes	<ul style="list-style-type: none"> – low entry costs, – low financial risk, – ensuring a steady income, – a strong presence in foreign markets by commercial brand and logo, – the licensee knows the local conditions, – does not require a large commitment of staff 	<ul style="list-style-type: none"> – the possibility to lose control over technologies and know-how, – lack of control over the maintenance of the quality on the foreign market(s), – the threat of disloyalty of the licensee, – relatively low income (royalties) compared to other forms of internationalization
Franchising	Sales of the rights by the domestic franchisor to conduct commercial activity by a foreign franchisee	<ul style="list-style-type: none"> – low entry cost, – the possibility of rapid foreign expansion, – the possibility of a simple expansion of both the large and distant markets 	<ul style="list-style-type: none"> – requires some control cost, – sharing profits gaining from foreign markets between the foreign franchisee(s) and a domestic franchisor, – requires appropriate qualifications of franchisees, – the possibility of potential conflicts between the partners, – the possibility of difficulties in maintaining uniform standards and quality, – the possibility of franchisee(s)' disloyalty
Branch	The creation of an organizational unit of the parent company on a foreign market, which is an organizational and legal part of that company	<ul style="list-style-type: none"> – full control – holding centralized control, – relatively good image of the branch on the local market 	<ul style="list-style-type: none"> – relatively complicated registration procedures
Joint venture subsidiary	The creation of a foreign subsidiary jointly controlled (minority and majority interests) by the parent company and a foreign partner	<ul style="list-style-type: none"> – synergy effect, – a combination of knowledge of the exporter and a local partner, – spreading the risk between the exporter and the partner, – good image of such a company on the local market (politically acceptable) 	<ul style="list-style-type: none"> – high entry cost, – high risk, – potential conflicts of interest of the exporter and the partner, – complicated registration procedures
Wholly-owned subsidiary	The creation of a foreign subsidiary wholly owned (100%) by a parent company	<ul style="list-style-type: none"> – full control – holding centralized control, – good image of such a company on the local market, – potentially the highest profitability 	<ul style="list-style-type: none"> – high entry cost, – high risk, – complicated registration procedures

Continued Table 3.4

Mode	Characteristics	Advantages	Disadvantages
Mergers and acquisitions (<i>brownfield investment</i>)	The merger of the acquisition of an existing foreign entity	<ul style="list-style-type: none"> – economies of scale, – combining complementary resources of a domestic company and a foreign partner, – enriching business activity scope (vertical, horizontal or diversified activities), – possible product or market extension 	<ul style="list-style-type: none"> – high costs, – high risk, – the necessity of integrating an entire company into present operations

Source: Wach K.: *Skutki akcesji do Unii Europejskiej dla polskich przedsiębiorstw*, Wydawnictwo Uniwersytetu Ekonomicznego w Krakowie, Kraków 2008, p. 50–53.

3.4. Ownership Structure for Greenfield and Brownfield International Businesses

Entrepreneurs starting up their businesses in different countries are subject to the procedures, rules and law, which is in force in a given country, however in different countries there are different registration procedures, different required documents, different organizational and legal forms, different tax laws. Starting a business in a given country, the entrepreneur is fully responsible for the choice of a legal form. The choice depends primarily on the purpose and the size of the venture, the number of associates, the type of the activity, the location, the form of taxation, capital ownership and development plans. Regardless of the diversity of existing legal regulations in specific countries, the entrepreneur can select one of the legal forms of activities:

- the establishment of an overseas representative office,
- the establishment of an overseas branch,
- the formation of an overseas subsidiary in the form of a limited company,
- the starting of self-employed, which is to run individual enterprises or to take an independent economic activity,
- the formation of business activities jointly with another person in the form of a partnership (including limited partnerships),
- the formation of one of the EU legal forms that are directly regulated in the EU legislation.

The coin of a *subsidiary* is not clearly defined in the literature. In practice, the subsidiary is defined as the entity where the parent company holds a majority share of stock or other controlled resource. In organizational and legal terms, the subsidiary can be established as a branch (a business division, a place of business), a joint venture subsidiary or a wholly owned subsidiary (in some languages called a „daughter subsidiary”)²⁹⁾. Some systemic approach in this area is introduced by the classification of foreign affiliates, devel-

²⁹⁾ Compare also: Rymarczyk J.: *Internacjonalizacja i globalizacja przedsiębiorstw*, PWE, Warszawa 2004, p. 189.

oped by the United Nations Conference on Trade and Development, (UNCTAD, which distinguishes between the following units (foreign affiliates or affiliate enterprises)³⁰⁾:

- **a subsidiary enterprise** or a subsidiary company (German: *Zweigunternehmen, Tochterunternehmen*, French: *entreprise filiale*, Polish: *spółka zależna*) – an incorporated enterprises in the host country, in which another entity directly owns more than a half of the shareholder's voting power, and has the right to point out or remove a majority of the members of the administrative, management or supervisory body,
- **an associate enterprise** or an associate company (German: *assoziierten Unternehmen*, French: *entreprise associée*, Polish: *spółka stowarzyszona*) – an incorporated enterprise in the host country, in which an investor owns a total of at least 10%, but not more than a half, of the shareholders' voting power,
- **a branch** (German: *Zweigniederlassung*, French: *succursale*, Polish: *oddział*) – a wholly or jointly owned unincorporated enterprise in the host country³¹⁾.

International Accounting Standard (IAS) and the European Union regulations introduce a bit different classifications, namely³²⁾:

- **a subsidiary** (German: *Tochterunternehmen*, French: *filiale*, Polish: *jednostka zależna – spółka córka*),
- **a jointly controlled entity** (German: *gemeinschaftlich geführten Unternehmen*, French: *entité contrôlée conjointement*, Polish: *jednostka wspólnie kontrolowana*),
- **an associate** (German: *assoziierten Unternehmen*, French: *entreprise associée*, Polish: *jednostka stowarzyszona*).

Treating a subsidiary as a synonym for a branch, a subsidiary enterprises and a joint venture is a kind of business practice (an usance)³³⁾. In the case, where a parent company owns 100% of the subsidiary, it is called a wholly-owned subsidiary.

Subsidiaries can be established in one of the national legal forms of the host country (table 3.5). Fundamental differences between organizational and legal forms in different countries consist mainly in variations of partnerships. Various organizational and legal forms in different countries, their features and determinants, are completely different, but there are four basic forms, which are common for almost all countries, namely³⁴⁾:

1. An Individual Enterprise:

- is subject to a simple registration procedure,

³⁰⁾ Word Investment Report 2005: Transnational Corporations and the Internationalization of R&D, United Nations Publication, New York – Geneva 2005, p. 297.

³¹⁾ A branch, according to the classification, is one of the following:

- permanent establishment (German: *dauernde Niederlassung*, French: *établissement stable*, Polish: *stałe przedstawicielstwo*),
- an unincorporated partnership or joint venture between the foreign direct investor and one or more third parties,
- lands and mobile assets operating within a country, other than that of the foreign investor.

³²⁾ Commission Regulation No. 69/2009/EC of 23 January 2009 amending Regulation No. 1126/2008/EC adopting certain international accounting standards in accordance with Regulation No. 1606/2002/CE of the European Parliament and of the Council as regards amendments to International Financial Reporting Standard (IFRS) 1 and International Accounting Standard (IAS) 27.

³³⁾ Compare also: Rymarczyk J.: *Internacjonalizacja i globalizacja przedsiębiorstw*, PWE, Warszawa 2004, p.193.

³⁴⁾ *Benchmarking the Administration of Business Start-Ups*, European Commission, Enterprise Directorate General, Brussels, January 2002, p. 24.

-
- owner has sole, personal responsibility for all business liabilities,
 - liability is unlimited and extends to private assets,
 - conducts general commercial activities.
2. **A General Partnership:**
- generally is subject to a simple registration procedure,
 - formed by two or more persons (in some countries, there are also restrictions on the total number of partners),
 - all partners are jointly and personally liable for the debts of the partnership,
 - liability is unlimited and extends to personal assets,
 - trading takes place under a common name (in some countries, this can constitute a separate legal identity for the partnership),
 - carries out general commercial activities with the purpose of engaging in trade or industry.
3. **A Private Limited Company**
- incorporated legal entity,
 - legal identity separate from and independent of the owners or shareholders,
 - liability to creditors is limited to the extent of the company's assets,
 - liability of shareholders/owners is limited to the amount of capital contributed and subscribed for,
 - at least one or more than one shareholder (in many countries, there are also limitations on the total number of owners/shareholders),
 - unable to raise any form of capital through public subscription or to be listed on a public capital market.
4. **A Public Limited Company** is similar to the private limited company, however there are a small number of important differences including those in the field of:
- sources of capital: public limited companies can raise capital through public subscription and can be listed on public debt and equity markets,
 - shareholders: there are no limits on numbers,
 - shareholding: the owners of the company hold shares. In some countries, the owners of private limited companies do so through quotas rather than shares.

An individual enterprise (also known as sole proprietorship, a sole trader, a one-man business) or a partnership would be appropriate for smaller-scale projects, a limited liability company (a private limited company) would be suitable for medium-sized projects, a joint stock company (a public limited company) is perfect for large scale ventures. Registration procedures and costs of doing business in the case of partnerships and individual enterprises (including self-employment) are much lower than in the case of limited companies. While choosing the legal form of a business the liability of shareholders has great importance (table 5.5). In the case of companies, shareholders are liable for their contribution only. Income of an independent partnership or individual business is taxed for individuals (income tax or personal income tax, PIT), income of companies are taxed by the corporate taxation (corporate income tax, CIT), taking into account the amount of these tax rates in particular countries.

Table 3.5

Criteria for the Legal Form Choice of the International Business

Criterion	Individual Enterprise	General Partnerships	Limited Companies	
			Private	Public
Size of a firm	micro or small	small	small or medium	large
Minimal capital	not specified in the law	usually not specified in the law (exception: limited partnerships)	strict defined in the law with some exemptions (at the medium level)	strict defined in the law with some exemptions (usually at the high level)
Registration	simplified procedures	usually simplified procedures (exception: limited partnerships)	usually more complicated procedures	relatively complicated procedures
Costs	low	relatively low	higher	relatively high
Memorandum of association	no	usually a civil agreement	in the form of a notarial deed	in the form of a notarial deed
Assets	all assets of the owner	all assets of the business entity and the owner(s)	own assets of the company	own assets of the company
Responsibility	unlimited (firm's assets and personal property of the owner)	usually unlimited (depends on the given legal form, exception: limited partnerships)	limited to the assets of the company (for shareholders to the amount of shares)	limited to the assets of the company (for shareholders to the amount of stocks)
Legal entity	lack of a separate legal status	usually lack of a separate legal status	separate legal status	separate legal status
Management	owner of the firm – single management	usually business partners	special and formal management bodies indicated in the law	special and formal management bodies indicated in the law
Dissolution	decided by the owner	dependent on business partners – difficulties when a partner leaves the partnership	dependant on the management body, independent from the company associates and/or shareholders	dependant on the management body, independent from the company associates and/or shareholders
Taxation	PIT / CIT*	PIT / CIT*	CIT	CIT

*PIT – Personal income tax, CIT – corporate income tax, according to the regulation in particular countries

Source: Wach K.: *Jak założyć firmę w Unii Europejskiej*, 3rd edition, Wolters Kluwer Polska, Kraków 2006, p. 29.

Classical Approaches towards Small Firm Internationalization

4.1. Introductory Notes on Historical Roots

At the beginning it must be explained that with the multitude of approaches to research on internationalization and on SMEs, there is no single theory which has received universal acceptance. There are also many classification criteria of existing models. It must also be emphasized that attitude of the researchers towards internationalization of small firms has been changing through the past decades. Dynamics of the researchers' approaches were the result of the continued changes in the world economies .

Business has been international for millenniums, however internationalization of business as a research topic up to 1970s concerned transnational corporations and large enterprises rather than SMEs. Small firms were "attached" to local and domestic markets. Such attitude towards small firms could be explained by many trade barriers that had existed up to the 90s of the 20th century. Overcoming those barriers required capital, personnel and skills often unavailable for smaller enterprises. Therefore, most of SMEs functioned locally.

Over time, barriers to international trade were being continually released. Trade agreements such as NAFTA (North American Free Trade Agreement), the EC (European Community), ASEAN (Southeast Asian Nations) and finally ESM (European Single Market, 1993) changed managerial view towards internationalization. A growing number of SMEs tried to take advantage of new environmental conditions. Thus, internationalization of the economies and accelerating globalization influenced researchers perception of small firm internationalization.

4.2. Stage Theories

The oldest and still significant stream of research examining small firm exporting strategy is stage theory of internationalization¹⁾. This theory assumes that a firm initially operates on the domestic market and only later, after achieving stable position, gradually expands its international activities undergoing through a couple of stages.

¹⁾ Daszkiewicz N.: *Teorie internacjonalizacji – ewolucja i perspektywy rozwoju*, [w:] Małe i średnie przedsiębiorstwa. Szanse i zagrożenia rozwoju, red. Daszkiewicz N., CeDeWu, Warszawa, 2007, s. 13–24.

Table 4.1

Selected Stage Models

Johanson and Wiedersheim (1975) ^{a)}	<ol style="list-style-type: none"> 1. No regular export activity; no import activity. 2. Export via agents to neighbouring countries. 3. Establishment of a sales subsidiary, export to more distant countries. 4. Production/manufacturing in a foreign market.
Bilkey and Tesar (1977) ^{b)}	<ol style="list-style-type: none"> 1. Management is not interested in exporting. 2. Firm fills unsolicited orders but does not actively pursue export markets. 3. Management actively explores exporting (passive exporter). 4. Firm begins experiment with exporting. 5. Firm becomes an active exporter. 6. Firm becomes a committed exporter.
Moini (1995) ^{c)}	<ol style="list-style-type: none"> 1. Non-exporters. 2. Partially interested exporters. 3. Growing exporters. 4. Regular exporters.
Leonidou and Katsikeas (1996) ^{d)}	<ol style="list-style-type: none"> 1. Pre-engagement- preceding firm's involvement in international activity. 2. Initial. 3. Advanced.
Cavusgil (1984) ^{e)}	<ol style="list-style-type: none"> 1. No engagement in export activity; sales in domestic market only, firm is not interesting in exporting. 2. Reactive engagement in export. Firm is seeking information about export opportunities. 3. Limited export to neighbouring countries. Limited experience and engagement. 4. Active engagement- systematic export to new countries. 5. Engagement – resource allocation between domestic and foreign markets.
Czinkota (1982) ^{f)}	<ol style="list-style-type: none"> 1. Firm is not interested in exporting – firm is not analysing export opportunities. 2. Firm is partially interested in exporting. Export is uncertain activity. 3. Firm is planning export activity and analyses opportunities of exporting. 4. Firm is experimenting with exporting. 5. Medium experienced exporters. 6. Big experienced exporters.

^{a)} Johanson J., Wiedersheim P.: *The Internationalization of the Firm: Four Swedish Cases*, "Journal of Management Studies", October, 1975, pp. 305–322.

^{b)} Bilkey W.J., Tesar G.: *The Export Behaviour of Smaller-Sized Wisconsin Manufacturing Firms*, "Journal of International Business Studies", Spring/Summer 1977, pp. 93–98.

^{c)} Moini A.H., *An Inquiry into Successful Exporting: An Empirical Investigation Using a Three-Stage Models*, "Journal of Small Business Management", July, 1995, pp. 9–25.

^{d)} Leonidou L.C., Katsikeas C.S.: *The Export Development Process: An Integrative Review of Empirical Models*, "Journal of International Business Studies" 1996, vol. 27 (Third Quarter), pp. 517–551.

^{e)} Cavusgil S.T.: *Differences Among Exporting Firms Based on Their Degree of Internationalization*, "Journal of Business Research" 1984, vol. 12, no. 2.

^{f)} Czinkota M.: *Export Development Strategies: US Promotion Policy*, Praeger, New York 1982.

Source: own research

Stage models assume that in the first phase the companies function only on the internal market, with no export activity. Moreover, firms initiate exporting activity in small steps, acquiring information, experience and know-how, what allows them to further develop this type of activity. From this perspective, internationalization is accomplished by establishing an export capability through a development and sequential process. In the review of stage-theory literature, Leonidou and Katsikeas²⁾ state that the sequence of activities in export development proc-

²⁾ Leonidou L.C., Katsikeas C.S.: *The Export Development Process: An Integrative Review of Empirical Models*, "Journal of International Business Studies" 1996, no. 27, pp.517–551.

ess can be divided into three broad stages: pre-engagement, initial and advanced. The pre-engagement steps includes firms that are not exporting, function only in their domestic market. Firms being in initial stage are sporadic or experimental exporters evaluating future export actions. Firms in advanced stage are actively and consistently engaged exporters. In spite, particular stage theories differ in number of stages, they suggest that firms undertake export activity incrementally. The selected proposals are presented in table 4.1.

Although particular models differ in number of stages, research classified the firms from surveyed group, assigning them to different stages of internationalization. Therefore, the research had static character.

Moreover, the stage theory itself, as well as the works verifying it, are based mostly on the export as criteria of internationalization. Export is, no doubt, the key element of internationalization, however, identification of internationalization with the export only is a significant simplification of the subject.

However, the most famous stage model, often regarded as the pioneering one is Johanson's and Vahlne's proposal from 1977.

The Uppsala Internationalization Process Model

Johanson and Vahlne, the researchers in the Department of Business Studies at Uppsala University in the mid- 1970s made empirical observations from a database of Swedish-owned subsidiaries abroad, and also from a number of Swedish companies in international markets. The observations indicated that Swedish firms frequently began internationalizing with *ad hoc* exporting. They developed their international operations in small steps. The SMEs would subsequently formalize their entries through deals with intermediaries who represented the focal companies in the foreign market. When sales grew, they replaced the intermediaries with their own sales organization, and as growth continued they began manufacturing in the foreign market to overcome the trade barriers that existed in the post World War II era³⁾. The researchers labelled this dimension of internationalization pattern the *establishment chain* (fig. 4.1 for: details see chapter 3.3).

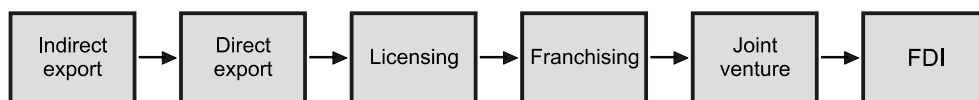


Fig. 4.1. The Establishment Chain of Internationalization Stages

Source: Own study

Moreover, the frequent feature of the pattern was that internationalization started in foreign markets which were close to the domestic market in terms of *psychic distance* (defined as factors that made it difficult to understand foreign environments). Then, the companies would gradually enter other markets which were further away in psychic distance terms.

Johanson and Vahlne primarily searched in the theory of the firm for explanations for the deviations between the extant theories of internationalization in relation to the Swedish pattern of internationalization. As a consequence, they developed their original model based

³⁾ Johanson J. Vahlne J.E.: *The Internationalization Process of the Firm – A Model of Knowledge Development and Increasing Foreign Market Commitments*, "Journal of International Business Studies", 1977.

on the work of Penrose (1966)⁴. The key assumptions of the 1977 model were uncertainty and bounded rationality. They also had two change mechanisms:

1. Firms change by learning from their experience of operations, current activities in foreign markets.
2. Firms change through the commitment decisions that they make to strengthen their position in the foreign market.

The commitment was defined as the product of the size of the investment times its degree of inflexibility. Experience builds a firm's knowledge of a market which influences decisions about the level of commitment and the activities that subsequently grow out of them: this leads to the next level of commitment, which encourages even more learning . Hence the model is dynamic.

Thus, the model focuses on the gradual acquisition, integration and use of knowledge about foreign markets and operations, and on the incrementally commitments to foreign markets. In particular, attention was focused on the increasing involvement in the individual foreign country⁵.

In the model the outcome of one decision (one cycle of events) constitutes the input to the next. The main structure is given by the distinction between the state and change aspects of internationalization variables:

1. The state aspects are the resource commitment to the foreign markets – market commitment – and knowledge about foreign markets and operations.
2. The change aspects are decisions to commit resources and the performance of current business activities (fig. 4.1).

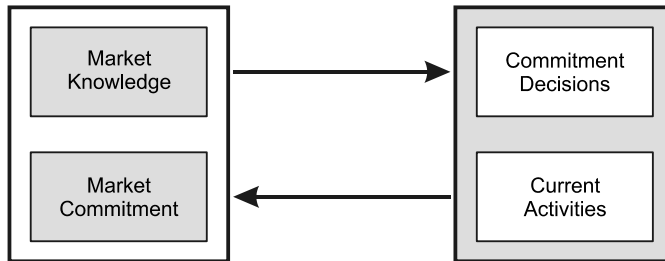


Fig. 4.2. The Basic Mechanism of Internationalization – State and Change Aspects

Source: Johanson J., Vahlne J.-E.: *The Internationalization Process of the Firm – A Model of Knowledge Development and Increasing Foreign Market Commitments*, "Journal of International Business Studies", 1977, vol. 8, no. 1, p. 26.

State aspects

Resources committed to foreign markets i.e. market commitment and knowledge about foreign markets that a firm possessed at given point of time. In turn, the reason the authors consider the market commitment is that they assumed that the commitment to the market affects the firm's perceived opportunities and risk.

⁴) Penrose E.: *The Theory of the Growth of the Firm*, Blackwell, Oxford 1966.

⁵) *Ibidem*.

Market Commitment. The authors assumed it was composed of two factors – the amount of resources committed and the degree of commitment (the difficulty of finding an alternative access to the resources). The degree of commitment is the higher the more the resources are integrated with other parts of the firm and their value is derived from these integrated activities. Thus, vertical integration means a higher degree of commitment than a conglomerative foreign investment.

The other part of market commitment – the amount of resources committed concerns the size of investment in the foreign market (including investment in organization, marketing, personnel etc.).

Market knowledge. In the model, the authors distinguished several kinds of knowledge (eg. knowledge of opportunities that initiates decisions, experiential knowledge which provides the framework for perceiving and formulating opportunities, general knowledge and market specific knowledge. A classification of knowledge used by the researchers was based on the way in which knowledge is acquired (Penrose, 1966). It is:

1. Objective knowledge – can be taught
2. Experience or experiential knowledge, can be learnt through personal experience. The authors believe the experimental knowledge is critical because it cannot be easily acquired as objective knowledge.

The researchers also distinguished between general knowledge and market specific knowledge. General knowledge concerns eg. Marketing methods, characteristics of customers, irrespective of their geographical location. The market specific knowledge is knowledge about characteristics of the specific national market – its business climate, cultural patterns and characteristics of individual customer firms and their personnel.

The authors also assumed that learning and commitment building take time. Commitment may decline, or even cease, if performance and prospects are not sufficiently promising. The process of internationalization will continue as long as the performance and prospects are favourable.

Moreover, there is a direct relation between market knowledge and market commitment. Knowledge was considered in the model as a resource. Thus, the stronger the knowledge the stronger was the commitment to the market.

It is worth mentioning that such attitude was innovative in 1977. The internationalization models based on resources and knowledge were described much later in the internationalization literature.

Change aspects

The change aspects are current activities and decisions to commit resources to foreign operations.

Current business activities. There is a delayed relationship between the most current activities and their consequences. The consequences occur when the activities are repeated more or less continuously. The longer the delay the stronger the commitment to the market. The more complicated and differentiated the product is, the stronger the total commitment as a consequence of current activities will be made.

Current activities are also the prime source of experience. It could be argued that experience is gained alternatively through hiring experienced staff. If the new personnel have already worked as representatives for the exporters, the delay is unlikely to occur. However, in many

cases experienced personnel is not for sale. At the time of entry to a new market the experience may not even exist. **It has to be acquired through a long learning process in connection with current activities.** That is why the internationalization process often takes so long.

Commitment decisions. The second change aspect is decision to commit resources to foreign operations. The authors assumed that such decisions depend on what decision alternative are raised and how they are chosen. Decisions are made in response to perceived problems and/or market opportunities. Problems and opportunities – the awareness of needs and possibilities for business action depend on experience. Like Penrose, the researchers state that opportunities and problems are a part of experience.

To sum up, when comparing different stage models they explain the internationalization process but do not focus on motives and factors of internationalization.

4.3. Eclectic Paradigm

Dunning's eclectic paradigm⁶⁾ addresses a specific aspect of internationalization – a foreign production which represents advanced stage in Uppsala model. The three, fundamental principles are derived from a variety of theoretical approaches; therefore Dunning labels his approach as 'eclectic'. According to them a firm will engage in international production when it fulfils the following conditions:

1. A company possesses **ownership-specific advantage** i.e. certain specific advantage not possessed by other competing companies. Moreover, foreign direct investment could occur only if the investing company possessed a particular advantage over domestic companies. It is because domestic firms understand their local business environment better than a foreign firm entering the market. The main source of competitive advantage is usually production technology, marketing and organisation, know-how, tangible and intangible asset easily transferable from one location to another.
2. **Internalization** – a company internalizes the use of its ownership-specific advantages. The main reason for a company to internalize markets is usually uncertainty. The greater the degree of uncertainty the greater the advantage will be for the company to control the transactions itself. Internalization is especially likely to occur when there is some transfer of knowledge involved. Another reason for internalization is the price mechanism. In external markets prices are quoted between buyers and sellers. In the internal market, on the other hand, prices are charged between related parties within the same organisation. The company itself sets the transfer prices of goods and services within the organizational boundaries. This leads to flexibility to help achieve the overall goals. However, there are limits in internalization. Increased costs of communication and control of the separate organisational units are specific examples.
3. **Location-specific advantage.** It must be more profitable for the company to take advantage of its assets in overseas, rather than in domestic market. Countries with different income levels also have different structure of demand. It is because, the type and mix of goods demanded varies with the income. Variations in the size and composition of markets therefore make an important location-specific factor. Other factors are the national governments, in terms of political climate and national attitude

⁶⁾ Dunning J.: *Multinational Enterprises and Global Economy*, Addison-Wesley, International Business Service, Wokingham 1993.

towards foreign direct investments, a company's perception of psychic distance, language and culture. Moreover, an important group of location-specific factors is the variations in production costs. Dunning argues that the single most important location-specific factor, at least at the global scale, is labour. The significance of labour as a production factor is the geographical variations in wage costs. Differences in wages both between developed countries and, especially, between developed and developing countries are important factors in the investment-location decision-making process.

In other words, Dunning focuses on the problem of how multinational enterprises (MNE) exploit ownership (O) and location (L) advantages by internalizing (I) markets rather than using the traditional international markets. The eclectic paradigm predicts that the MNE will establish production where it can best take benefit from its advantages, as defined by OLI-parameters. The exploitation is only possible because of market imperfections.

The model implies rational behaviour of firms which is only possible with instant and complete information, unlimited information processing capacity and perfect qualifications for evaluating information. This can never be found in reality but the strongest chances for reaching the ideal exist in large and experienced firms. Thus, the eclectic paradigm can therefore be expected to be better for explaining foreign production of large firms than for small ones⁷⁾.

4.4. Resource-Based Models

The development aspect of the stage models is consistent with some elements in the resource-based view of the firm proposed by Barney (1991)⁸⁾. The resource-based view (RBV) argues that firms possess resources, a subset which enable them to achieve competitive advantage, and a subset of those that lead to superior long-term performance. Resources that are valuable and rare can lead to the creation of competitive advantage. That advantage can be sustained over longer time periods to the extent that the firm is able to protect against resource imitation, transfer, or substitution. In general, empirical studies using the theory have strongly supported the resource-based view. The key points of the theory are:

1. Identify the firm's potential key resources.
2. Evaluate whether these resources fulfil the following criteria (referred to as *VRIN*):

Valuable – a resource must enable a firm to employ a value-creating strategy, by either outperforming its competitors or reduce its own weaknesses. Relevant in this perspective is that the transaction costs associated with the investment in the resource cannot be higher than the discounted future rents that flow out of the value-creating strategy⁹⁾.

Rare – to be of value, a resource must be rare by definition. In a perfectly competitive strategic factor market for a resource, the price of the resource will be a reflection of the expected discounted future above-average returns¹⁰⁾.

⁷⁾ *Ibidem*.

⁸⁾ Barney J.B.: *Firm Resources and Sustained Competitive Advantage*, "Journal of Management" 1991, vol. 17, pp. 99–120.

⁹⁾ Mahoney J.T., Pandian J.R.: *The Resource-Based View Within the Conversation of Strategic Management*, "Strategic Management Journal" 1992, vol. 15, no. 5, pp. 363–380.

¹⁰⁾ Barney J.B.: *Strategic Factor Markets: Expectations, Luck and Business Strategy*, Management Science 1986, vol. 32, no. 10, pp. 1231–1241.

In-imitable – if a valuable resource is controlled by only one firm it could be a source of a competitive advantage. This advantage could be sustainable if competitors are not able to duplicate this strategic asset perfectly¹¹⁾. If the resource in question is knowledge-based or socially complex, causal ambiguity is more likely to occur as these types of resources are more likely to be idiosyncratic to the firm in which it resides. Conner and Prahalad go so far as to say knowledge-based resources are “...the essence of the resource-based perspective”¹²⁾.

Non-substitutable – even if a resource is rare, potentially value-creating and imperfectly imitable, an equally important aspect is lack of substitutability. If competitors are able to counter the firm’s value-creating strategy with a substitute, prices are driven down to the point that the price equals the discounted future rents resulting in zero economic profits¹³⁾.

The VRIN characteristics are individually necessary, but not sufficient conditions for a sustained competitive advantage. Within the framework of the resource-based view, the chain is as strong as its weakest link and therefore requires the resource to display each of the four characteristics to be a possible source of a sustainable competitive advantage¹⁴⁾.

Learning internationalization i.e. undergoing through the stages requires development of skills and know-how that can lead to firm success in a foreign market. Firms that develop superior resources and capabilities can generate superior profits¹⁵⁾. Thus, to internationalize, firms are more likely to establish a base of operations from which they can test export activity and develop the knowledge necessary for successful exporting.

The analysis based on resources describe not only the actual condition but also the potential that SMEs have in the process of activity internationalization¹⁶⁾.

Theory based on resources emphasizes the fact that SMEs are heterogenic, just because of the multitude of resources at their disposal and capabilities of their use.

This results in an accessibility to various paths of growth, internationalization and strategies and actions applicable for this purpose.

However, more recent research has used resource-based theory to propose that small firms do not necessarily follow the stages. Some of them are international at inception.

4.5. International at Founding: Born Global SMEs

Since Johanson and Vahne¹⁷⁾ started their studies on the internationalization process of small firms much research has been done. However, the main research stream proposed that small firms internationalize their activities through a series of progressive stages. In 1994 McDougall and Oviatt suggested that at least some SMEs are international at founding (that

¹¹⁾ *Ibidem.*

¹²⁾ Conner K.R., Prahalad C.K.: *A Resource-Based Theory of the Firm: Knowledge versus Opportunism*, “Organization Science” 1996, vol. 7, no. 5, pp. 477–501.

¹³⁾ Barney J.B.: *Strategic... op. cit*

¹⁴⁾ Barney J.B.: *Firm... op. cit.*

¹⁵⁾ Dunning J.: *op.cit.*

¹⁶⁾ Barney J.B.: *Firm... op. cit.*

¹⁷⁾ Johanson J., Vahlne J.-E.: *The Internationalization... op.cit.*

is involved in significant cross-border business activities)¹⁸. These firms do not follow the successive stages suggested by some researchers.

Thus in 1994, the literature started to differentiate two discreet ways that small firm internationalize:

1. "International at founding" (Oviatt and McDougall, 1994);
2. "International-by-stage" (Johanson and Vahlne, 1977).

Wolff and Pett ask one more question: are there only two means by which small firms internationalize?¹⁹ The researchers suggest that such division represent the end points of continuum for internationalization. The question "might there be firms that are not *international-at-founding* but that are able to skip stages in their effort to internationalize"? has received increased attention²⁰. Thus, does the stage theory of small business internationalization apply to all "domestic-at-founding" firms, or is it a special case explanation for how (some) small firms internationalize²¹.

It is necessary to emphasize that a decade ago, globalization process significantly accelerated. With increasing global competition, falling barriers to international trade and fast development of ICTs many SMEs were pressed to compete on international markets. Some of them developed capacity to leapfrog steps in the export-development process.

The main goal of the Wolff and Petts' study was to examine the export activities that small firms use in pursuing an internationalization strategy. The research questions were:

1. Are there discernable patterns in the competitive actions used by small firms in carrying export activities?
2. Is there any influence of firm size on its export activity? Is there any relationship between size and competitive pattern of exporting?
3. Lastly, they wanted to determine the relationship among size, competitive pattern and export performance for small exporting firms.

They formulated two hypothesis:

H1: *Very small exporting firms use a competitive patterns of focused export activity.*

H2: *Large small exporting firms use a competitive pattern of broad-based export activity.*

The analysed sample was composed of 157 small firms (500 employees or fewer) that had their headquarters in a Midwestern U.S. state. All of them were actively exporting to markets outside the U.S. They divided the sample into three groups: (1) under 25 employees (very small), 26–100 employees (mid-range) and 101–500 employees (larger).

Larger (small) firms exhibited competitive patterns consistent with their size-related resource base. However smaller (small) firms did not exhibit competitive patterns that could be viewed consistent with their size-related resource base. Thus, no significant difference in export intensity across three size category was found.

¹⁸) McDougall P.P., Oviatt B.M.: *Explaining the Formation of International New Ventures: The Limits to Theories from International Business Research*, "Journal of New Business Venturing", 1994, vol. 9, pp. 469–487.

¹⁹) Wolff J.A., Pett T.L.: *Internationalization of Small Firms: An Examination of Export Competitive Patterns, Firm Size and Export Performance*, "Journal of Small Business Management", April, 2000, pp. 34–47.

²⁰) McDougall P.P.: Oviatt B.M., *Explaining.... op.cit.*

²¹) Wolff J.A.: Pett T.L., *Internationalization... op.cit.*

The empirical evidence lead to conclusion that stage theory does not depict the export-development process for at least some small firms. However, while some firms may follow the stepwise progression of export development and internationalization, at least some other firms – contingent upon their resources – are able to follow a different pattern of internationalization.

Thus, the primary conclusion was that stage models of internationalization process was no longer the only representation of how small firms pursue an international strategy.

4.6. REM model

REM model describes and explains internationalization of post-soviet firms (figure 2.3). The biggest soviet firms were analysed: GAZPROM and LUKoil. The only possible method was a case study because of lack of data about soviet firms abroad. Moreover, GAZPROM and LUKoil could be compared with foreign competitors, possessed huge resources and were global firms.

1. **The R-factor** – a reason for internationalization creates the foundation of the REM model as it answers why a firm makes decision about internationalization? Some firms may internationalize due to external motives e.g. the competitors and customers function abroad or have become global. What concerns internal factors a firm may have a goal to increase profitability. Growth seeking can thus push firms to begin internationalization. Both external and internal motives determine the balance between the pro- and anti-internationalization arguments i.e. whether a company decides to begin internationalization or not.
2. **The E-factor – environmental choice** – the environment selection stands for the choice of business environment(s). There is multitude of factors which influence environment selection. Dunning points at four main reasons for internationalization:
 - 1) **resource seeking** – availability of local partners to jointly promote knowledge and/or capital-intensive resource exploitation;
 - 2) **market seeking** – mostly large and growing domestic markets, availability and price of skilled and professional labour, presence and competitiveness of related firms (e.g. leading industrial suppliers), growing importance of promotional activities by regional or local development agencies;
 - 3) **efficiency seeking** – mainly production cost related (labour, materials), freedom to engage in trade intermediate and final products, presence of agglomerative economies e.g. export processing zones, investment incentives e.g. tax breaks, grants, subsidized land;
 - 4) **strategic assets seeking** – availability of knowledge- related assets and markets necessary to protect or enhance, specific advantages for investing firms²²⁾.

Thus, a choice of an environment may depend on the host environment policy. Also the home policy is taken into consideration, as the governmental institutions in the home market may promote or restrict internationalization.

3. **The M-factor – mode choice** – How does a firm become international? The modal choice answers the question of how a firm implements its internationalization. It must

²²⁾ Dunning J.H., *Location and the Multinational Enterprise: A Neglected Factor?*, “Journal of International Business Studies”, 1998, vol. 29, no. 1, pp. 45–66.

be stressed that universally superior mode does not exist. The selection between the different modes is influenced by many issues such as the control requirement, commitment, costs, experience, capabilities and resources possessed or national/cultural preferences (for details on modes see chapter 3.3).

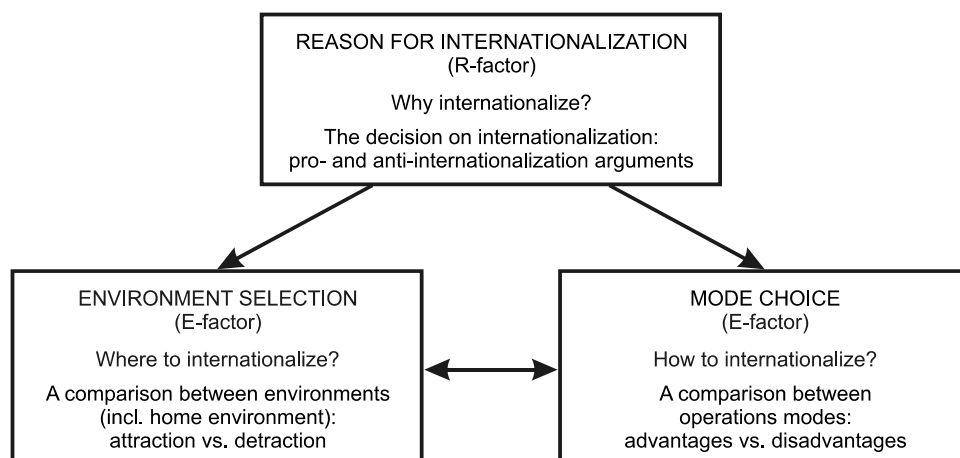


Fig. 4.3. The REM Model

Source: Liuhto K.: *A Russian Oil and Gas Giant Goes West*, Published in: K. Liuhto (ed.), *East goes West, The Internationalization of Eastern Enterprises*, "Studies in Industrial Engineering and Management", Lappeenranta University of Technology, 2001, no. 14, p. 21.

4.7. Resource-Sector Model of SME Internationalization for Transformed Economies

REM Model was the only proposition of description of SME internationalization in transformed economy. Still it was proposed for transnational corporations can also be used to describe small firm internationalization. Other models were rather suitable to characterize small firm internationalization in market economies.

It should be explained that SMEs in transformed economies were in a different situation than firms from "old" European Union. In the early 1990s they had to adjust to market economy conditions. A decade later they joined the European Single Market and suddenly started to compete in highly competitive environment.

The resource-sector model is based on two assumptions:

1. The key role of owner-manager in internationalization process;
2. Resources, environment and sector are other factors that determine strategic decisions of SMEs.

Except REM model also Wiklund's growth model was used to construct resource-sector model (fig. 4.4). It is because often firms which seek for growth often enter foreign market (to grow/develop).

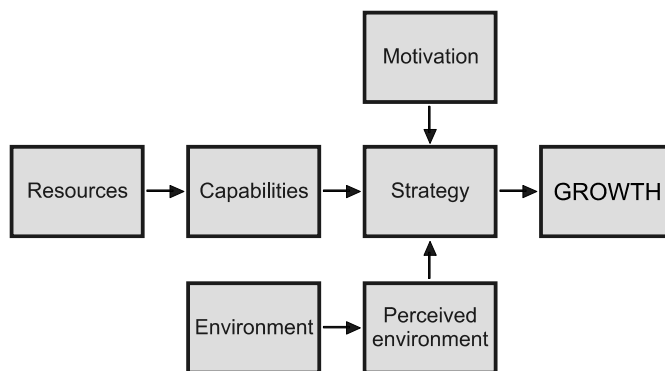


Fig. 4.4. Wiklund Model

Source: Wiklund J.: *Theoretical perspective in research on firm growth*, RENT X Conference, Brussels 1996.

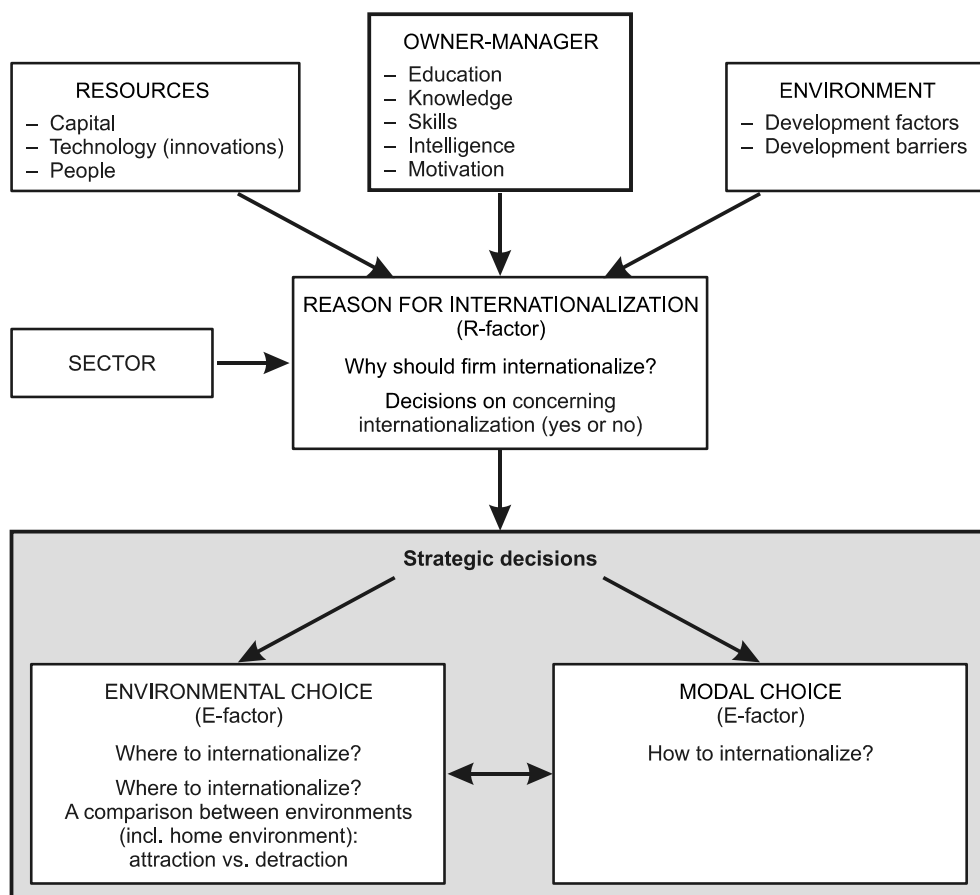


Fig. 4.5. Resource-Sector Model of SME Internationalization

Source: Daszkiewicz N.: *Internacjonalizacja małych i średnich przedsiębiorstw we współczesnej gospodarce*, SPG, Gdańsk 2004, p. 60.

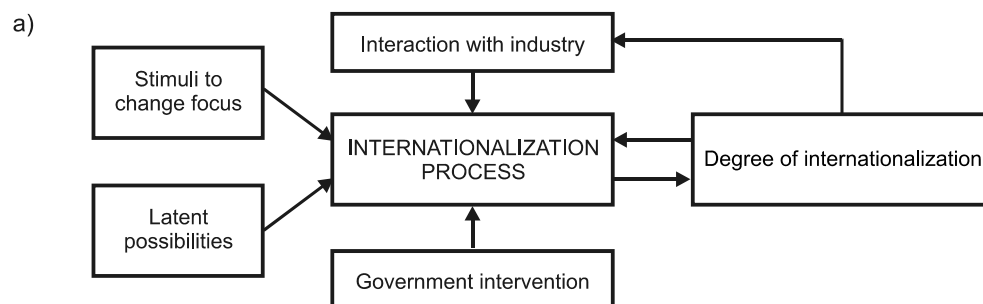
In Wiklund's model owner-manager plays the most important role. His/her knowledge and experience are the important part of resources that decide about an opportunity of making use of other resources. Perceived environment, in turn, decides about the strategic choice. Moreover, this choice is determined by owner-manager's motivation and opportunities of making use of the resources that are at the firm's disposal. The smaller is the gap between environment and its perceiving by owner-manager the bigger are the chances for success in realization of the chosen strategy. The size of the gap is the effect of owner-manager consciousness, his knowledge, experience, access to information etc. That is why, effective use of the resources at firm's disposal (knowledge, experience, skills) is very important. Their coexistence and cooperation is the key condition for firm's growth. Growth, in turn, is necessary condition (but not enough) to develop firm's international activity.

4.8. Analytic Model

Havnes states that description of internationalization process is also description of development or change of the firm²³⁾. The firm moves from area of operation to another, from market to market. The changes involved may be a change of focus alone, or may be associated with growth of the firm. Principally there is no significant difference between the changes associated with internationalization and the changes the firm faces as a result of technological development, product renewal or growth. In all cases a process of change needs to be initiated and maintained; new skills must be learned, new sources of information must be established and consequently the basis of experience is extended.

Moreover, any process can be analysed in two alternative perspectives: in view of the results or outcomes of the process (fig. 4.6a) or in a view, the process itself and relationships itself (fig. 4.6b).

Figure 4.6 delineates the two scopes that may chosen for analysing the internationalization process. Figure 4.6a focuses on outcomes. It provides insight necessary for predictions, setting goals or merely measuring the internationalization. Figure 4.6b focuses on the process. Choice between these two scopes depends on the purpose of the studies.



²³⁾ Havnes P.A.: *Internationalization of Small and Medium-sized Enterprises: an Analytical Model*, RENT VIII Conference, Tampere 1994.

b)

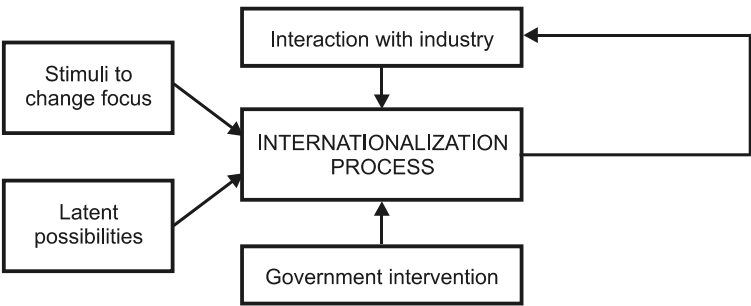


Fig. 4.6. Internationalization: a) focus on outcome, b) focus on process
Source: Havnes P.A.: *Internationalization of Small and Medium sized Enterprises: an Analytical Model*, RENT VIII Conference, Tampere 1994, p.13.

Internationalization of SMEs through Networks

5.1. Small-Firm Networks

According to Axelsson and Johanson (1992), a network involves “sets two or more connected exchange relationships”¹⁾. Thus, the nature of relationships among various groups e.g. customers, suppliers, competitors, family will influence strategic decisions, and the network involves resource exchange among its different members.

Early entrepreneurship research focused on the characteristics of the single entrepreneur. In particular, Birley (1985)²⁾ recognized that networks play a catalyst role in organizational emergence, and Aldrich and Zimmer (1987)³⁾ proposed a perspective “which views entrepreneurship as embedded in networks of continuing social relations”. Since these studies, networks have been embraced as an instrument for investigating the creation and development of new ventures.

Much of the small firm network research focuses on general network influence on firm behavior however, certain studies highlight the potential role of networks in small firm internationalization.

There are many types of networks and different criteria of their classification. However, M. Perry differentiates four types of network according to the basis of the relationship through which it is sustained (table 3.1). These types are (I) personal and ethic ties, (II) geographical proximity, (III) organizational integration, (IV) buyer-supplier linkages⁴⁾. In spite of that these forms of networks overlap, it is important to recognize such interactions between different networks forms. But there are also benefits in classification that is based on dominant network structure existing in any particular case.

¹⁾ Axelsson B., Johanson J.: *Foreign Market Entry: The textbook vs the Network view*, In: Axelsson B., Easton G. (eds.), *Industrial networks: A New view on reality*, London, Routledge, 1992, pp. 218–231.

²⁾ Birley S.: *The role of Network In the entrepreneurial process*, “Journal of Business Venturing” 1985, no. 1, pp. 107–117.

³⁾ Aldrich H., Zimmer C.: *Enterprise through social networks*, In: D. Sexton and R. Smilor (eds.), *The Art and Science of Entrepreneurship*, Cambridge, Ballinger 1986.

⁴⁾ Perry M.: *Small Firms and Network Economies*, series “Routledge Studies In Small Business”, Routledge, London and New York, 2007, p. 24.

Personal and ethnic networks

Small-business networks constructed around social networks develop through associations formed by family, friends and acquaintances. The construction of social network is influenced by:

1. The personal network of relations with specific individuals and the business activities to which they are attached.
2. The wider cultural dimension in which participants operate and which transfers values, attitudes and behaviors that shape the nature of the relationships that are formed⁵⁾.

The strength of social networks derives primarily from trust and commitment among family, friends and close associates (managers, employees, suppliers customers and business advisors). The communities of socially and personally connected business give mutual support to their members. Moreover, resource sharing may be practiced and mutual interest is stable and predictable. Long-term relationship can protect small firms from market fluctuations and the threat of ostracism prevents the members of the network from breaching trust. Strong personal ties can be formed between persons from the same family, region of origin or broader ethnic group, but the feature of enduring networks is that trust is extended beyond such ties through individual friendship and personal recommendation. This flexibility has been claimed as a major source of strength within Chinese and other ethnic business communities.

Community-based networks

The key characteristic of this network type is special containment within a specialized industrial district. Social networks and family business are a component of spatially embedded networks; community-based networks are reinforced by integration through intermediary organizations that share the strong affinity to the particular locality. A combination of influence with familiar, legislative, political and historical forces promote a commitment to place, the accumulation of knowledge and a capacity for a high degree of industrial specialization. Specialization, in turn, may lead to disaggregation of production chain and/or extensive collaboration and subcontracting linkages between individual businesses. Firms compete while simultaneously learning about changing markets and technologies through informal communications, collaborative projects and common ties.

Geographical specialization in the Italian districts have brought success in high-quality craft-based industries and sustained a commitment to a collective marketing identity, a high use of subcontracting and an industry structure in which firms concentrate on specific skills.

Silicon Valley's strength in innovative small firms is a result of labor market that allows employees and their knowledge to move between organizations and entrepreneurs to hive off businesses from existing enterprises⁶⁾.

Organizational networks

Another form of network organization is held together through relations of ownership, investments or shared membership. The degree of integration and cooperation within these networks varies according to the form of the relationship. While the relationship between firms under a common ownership may provide a limited division of responsibility, business

⁵⁾ *Ibidem*, pp. 24–25.

⁶⁾ Angel D.: *High technology agglomeration and the Labour market: the case of Sillicon Valley*, "Environment and Planning" 1991, A, Vol. 23, No. 10, pp. 1501–16, Quoted In: *ibidem*, p. 27.

practice often divides ownership across separate operating units. Regulatory conditions also affect propensity to set up a satellite firms; for instance in Italy, where the avoidance of tax and other obligations on large firms provides a strong incentive for individual entrepreneurs to divide their business interests among many small firms. Joint-ventures and strategic alliances involve two or more firms in the control of a third-party ventures, a form of network that can be formed with a comparatively narrow and short-term focus. However, further cooperation among partners might be encouraged.

Examples of these are the *keiretsu* in Japan and the *chaebol* in Korea; franchising can be also an example of an organizational network because it provides a way of overcoming distance and territorial limits on interaction.

The advantage of this type of network (common membership of a third-party association, established independently of any one company) is the willingness of participants to accept some degree of collective discipline or resource sharing from an external entity that is outside the individual firm's control.

Buyer-supplier networks

Buyer-supplier networks are formed through relational contracting or ongoing relations of exchange, interaction and mutual development between two or more firms⁷⁾. These connections are something more than the links among "normal" transactions; they involve some degree of commitment to mutual development and willingness to accept some degree of involvement by one firm in the operation of another.

The advantage of such relationship can be realized through co-engineering of new products, which involves supplier participation in new product or process design. Relational contracting exists is perceived as a large part of Japan's post-war economic strength.

Table 5.1

Small-Firm Networks

Network type	Linkage characteristics	Examples	Issues
Family and ethnic	Ties based on family and personal contacts, embedded in close-knit communities	Overseas Chinese, ethnic minority enterprise, family business	Dependence on ethnic resources, enclave economies, impact on racism
Place	Geographical proximity and shared commitment derived from common values and goals	Third Italy, Silicon Valley, Japan's jiba sangyo	Sustainability, variations between industrial districts, origins as a barrier to replication
Organizational	Investment or ownership ties or membership of industry associations	Business groups, joint-ventures, chamber of commerce, industry bodies	Small firm status in horizontal and vertical groups, influences on industry cooperation
Buyer-supplier	Interaction to enhance role of supplier and subcontractors	Relational subcontracting	Extent of change in subcontracting, use of vendor rating, impact of global manufacturing

Source: Perry M.: *Small Firms and Network Economies*, Routledge Studies In Small Business, London – New York 2007, p.25

⁷⁾ Sayer A., Walker R.: *The New Social Economy*, Blackwell, Oxford 1992, Quoted In: *ibidem*, p. 28.

Since the 1990s, buyer-supplier relationships have been changing – the increasing management of inter-firm linkages through formalized agreements, including evaluation programs, just-in-time delivery schedules, supplier partnerships and technology development agreements are the examples.

Networks – from the bottom-up

It must be explained that networks are difficult to observed and to analyze. Methods for describing networks differ according to whether their focus is on individual firm and its paired relationships (dyads) or the network as a whole, including multiple linkages⁸⁾. A basic way of analyzing the linkages surrounding an individual firm is to distinguish their intra-firm, inter-firm and extra-firm connections.

Firm-centered analysis

To focus on network relations a distinction between compulsory and voluntary networks should be done. Compulsory networks are those to which organization must belong in order to survive and operate successfully (e.g. banks, accountants). In turn, participation in a local chamber of commerce, club is classified as voluntary networking.

A closely related distinction has been done between formal and informal networks⁹⁾. Formal networks include banks, layers and business associations, while informal include family, friends, colleges etc.

Bryson et al. (1993) propose a focus on links that are necessary to be in business. These are: 1) demand related networks -associated with clients;

- 2) supply-related networks- associated with cooperative relations used in the process of delivering a service or product;
- 3) support related networks - which include agents such as banks, business advisers and some social contacts¹⁰⁾.

Network-centered analysis

There is a school of thinking in organization and management theory that views networking as a competitive strategy. Thus, this perspective regards networks as a mode of organization whose purpose is to position a firm in a favorable environment, to gain access to valuable external resources and expertise. The key components of network structure for analysis include network density, accessibility centrality, strength of ties, homogeneity and stability.

Networks – from the top down

Looking from the top-down, places are associated with distinctive systems of business organization. This perspective views economic organization (firm) as a “subsystem of a more encompassing society, policy and culture”. Whitely proposes that business systems can be divided according to the character of three main components:

- 1) firm characteristics – are assessed in terms of balance between externalization and internalization, with high level of business specialization (which results in various

⁸⁾ Birley S., Cromie S., Meyers A.: *Entrepreneurial networks: their emergence in Ireland and overseas*, “International Small Business Journal” 1991, vol. 9, no. 4, pp. 56–74.

⁹⁾ Birley S.: *The role... op.cit.*

¹⁰⁾ Bryson J., Wod P., Keeble D.: *Business Networks, small firm flexibility and regional development in UK business services*, “Entrepreneurship and Regional Development” 1993, no. 5, pp. 265–277.

forms of market contracting). Firm characteristics are used to explain the extent to which an economy tends towards relational or competitive market relations.

- 2) market structures – are differentiated according to the extent to which they are relational or competitive
- 3) management-labour relation – it is a third component of a business system. It shows how firm characteristics are influenced by the opportunities for adopting particular forms of workplace organization. It illustrates the links between workplace organization and business characteristics: (I) methods for obtaining workforce cooperation and commitment, (II) skill accreditation methods.

5.2. Network Perspective of SMEs Internationalization

The internationalization process of SMEs from network perspective has been intensively investigated during the last two decades¹¹⁾.

Johanson and Mattsson¹²⁾ developed a network model of internationalization based on business network research. They discussed firms' internationalization in the context of both firm's own business network and the relevant network structure in foreign markets. Their model highlighted the importance of the network structure outside the firm's own business network. According to the network approach internationalization is seen as a process in which relationships are continuously established, developed, maintained and dissolved with the aim of achieving objectives of the firm. Johanson and Mattsson (1988) identified four stages of internationalization: 1) the early starter, 2) the late starter, 3) the lonely international, 4) international among others (fig. 5.1)

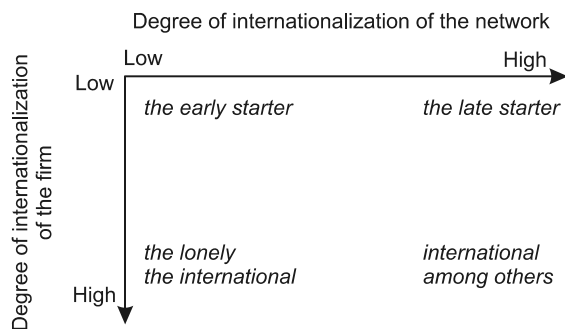


Fig. 5.1. Internationalization and the network model

Source: J. Jan, M. Lars-Gunnar. *Internationalization in Industrial System – A Network Approach*, in: *Strategies in Global Competition*, Neil Hood and Jan-Erik Vahlne (eds.), Croom Helm, London 1988, pp. 468–486.

¹¹⁾ Axelsson B., Johanson J.: *op. cit.*; Coviello N.E., Munro H., *Network relationships and internationalisation process of small software firms*, "International Business Review" 1997, vol. 6, no. 4, pp. 361–386; Ellis P.D., *Social ties and foreign market entry*, "Journal of International Business Studies", 2000, vol. 31, no. 1, pp. 443–469.

¹²⁾ Johanson J., Lars-Gunnar M.: *Internationalization in Industrial System – A Network Approach*, in: *Strategies in Global Competition*, N. Hood, J.-E. Vahlne (eds.), Croom Helm, London 1988.

For an *early starter* it can be problematic to develop a network. Sometimes costs can be too high to gain advantages. When both degree of internationalization of the firm is low and the degree of internationalization of network is low, the firm can follow the traditional step-by-step model (the U-model).

The biggest problem for the *lonely international* is the co-ordination of the international activities. The firm might also face pressure as far as the adjustment of resources is concerned. The problems faced by the *late starter* are different. The firm is to a large extent dependent on other firms that already exist within the network. The other firms might try to hinder the firms' entrance into the internationalized market. The customers and/or suppliers may also "pull" the firm into the international network. The *international among others* operates within the international network, where differences among countries decrease over time. The utilization of external resources can be considered as the best option for the firm to expand internationally. Thus, it is typical that for example mergers, joint ventures and alliances occur, which evidently will have an effect on the existing network.

Coviello and Munro¹³⁾ found out that network relationships have an impact on foreign market selection and mode of entry in the context of ongoing network process. The conclusion of their empirical studies led them to develop a model that combines the process model and network approach. The purpose of the research was to empirically examine the internationalization process of small firms, integrating the incremental or stage views of internationalization with the network perspective. The research questions were:

1. How the internationalization process of small software firm is manifested in their choice of foreign market and mode of entry,
2. How network relationships influence the small software firm's choice of foreign market mode of entry.

The small software firm's internationalization process is rapid. The rapid and successful growth of the firms appears as a result of their involvement in international networks, with major partners often guiding foreign market selection and providing mechanism for market entry. Thus, networks not only drive internationalization but also influence the pattern of market investment.

Chetty and Patterson¹⁴⁾ (2002) pointed out that the concept of business networks came from the social exchange perspective on social networks. Internationalization process of SMEs from this perspective seem to be a more useful concept since it is possible to overcome the problems of limited resources, experiences and credibility.

5.3. Impact of Network Relationship on SMEs Internationalization Process

Many research support the argument that networks have a significant impact on internationalization processes – its pace, pattern, market selection and entry mode. Mohamed Zain and Siew Imm Ng from Malaysia analyzed literature from developed nations concerning relationship between networks and internationalization of SMEs and proposed concep-

¹³⁾ Coviello N.E., Munro H.: *Network ... op.cit.*

¹⁴⁾ Chetty S., Patterson A.: *Developing internationalisation capability through industry groups: the experience of telecommunications joint action group*, "Journal of Strategic Marketing", 2002, no. 10, pp. 69–89.

tual framework and interesting methodology for their research. The general objective of the research was to investigate the impact on software SMEs' internationalization process in Malaysia. The research used a multisite case study methodology and included the following questions:

1. How is the internationalization process of SMEs manifested in their choices of foreign markets and modes of entry?
2. How do network relationships of SMEs impact their international market development?
3. How do network relationships of SMEs impact their marketing-related activities within the international markets?¹⁵⁾

The researchers, on the basis of the literature, formulated the following propositions (table 3.2):

1. *Network relationships trigger and motivate firms, initial internationalization intension* – network relationship trigger knowledge opportunities and motivate firms to enter international markets. Moreover, working together can help firms overcome adversity and lack of motivation.
2. *Network relationships influence firms, market-selected decisions*
3. *Network relationships influence firms, entry-mode decision*. Inter-firm relationships (e.g. with clients, customers) influence market selection and entry- mode of small firms. Major partners often guide foreign market selection and provide mechanism for market entry¹⁶⁾.
4. *Network relationships allow firms, access to additional relationships and established channels*. Starting business in a foreign country requires a firm to develop a distribution channel to market its products. A way to overcome this problem is to develop network relationship with a foreign partner – particularly, one with well-established distribution channel¹⁷⁾. Networks also help firms connect to potential buyers. The use of alliances and cooperative arrangements by SMEs can improve foreign market penetration by providing access to additional relationships.
5. *Network relationships allow firms' access to local market knowledge*.
6. *Network relationships help firms to obtain initial credibility*. Network relationships help firms to access local market knowledge and obtain business information and contacts¹⁸⁾. Credibility and trust are developed through working together.
7. *Network relationships help firms in lowering costs and minimizing risk of internationalization*. Business networks in the form of social capital based on interlocking connections provide Asian firms with a range of competitive advantage eg. reduced transactions and search costs for buyers. When entering new markets, decision makers typically minimize their risk by drawing on their known contacts and connections. Through collaboration firm can achieve rapid internationalization.
8. *Network relationship influence firms' internationalization pace and pattern*¹⁹⁾. found out that the pace and pattern of international market growth and choice of entry mode for small firms is influenced by close relationships with customers. Also, Coviello and

¹⁵⁾ Zain M., Ng S.I: *The Impacts of Network Relationships on Firms' Internationalization Process*, "Thunderbird International Business Review", 2006, Vol. 48, No. 2.

¹⁶⁾ Coviello N.E., Munro H.: *Network... op. cit.*

¹⁷⁾ *Ibidem.*

¹⁸⁾ Chetty S., Patterson A.: *Developing.... op. cit.*; Coviello N.E., Munro H., *Network... op. cit.*

¹⁹⁾ Lindqvist M.: *Internationalization of small technology-based firms: Three Illustrative Case Studies on Swedish firms*, Stockholm School of Economic Research, Stockholm 1988.

Munro (1995)²⁰⁾ found that through network relationships firms are able to internationalize very quickly by linking themselves to extensive, established networks.

9. *Network relationships constraint firms' future scope and market opportunity.* Although network relationships facilitate SMEs' international growth, they also constrain the pursuit of other opportunities. Network relationships can inhibit product-development and market-diversification activities due to firms' network bond and high dependency.

Table 5.2

The Impacts of Network Relationships on Firms' Internationalization Process

Impact	Researchers
Trigger and motivate firms, internationalization intension	Sharma&Johanson (1987), Conviello and Munro (1995), Korhonen et al. (1995), Anderson (1996), Ellis (2000), Chetty and Patterson (2002)
Influence firms' market – selection decision Influence firms' entry – mode decision	Bell (1995), Conviello and Munro (1997)
Gain access to additional relationships and established channels	Welsch (1992), Bjorkman and Kock (1995), Conviello and Munro (1995), Chetty and Patterson (2002)
Gain access to local market knowledge Obtain initial credibility	Larson (1992), Bucklin and Sengupta (1993), Conviello and Munro (1995), Fukuyama (1995) Conviello and Munro (1995), Osland and Yarpak (1995), Turnbull et al. (1996), Nahapiet and Ghoshal (1998), Chetty and Patterson (2002)
Lower costs and minimizing risk of internationalization	Dichtl et al. (1990), Hamilton (1991), Katsikeas and Morgan (1994), Conviello and Munro (1995), Burgel and Muray (2000), Ellis and Pecotish (2001), Chetty and Patterson (2002)
Influence firms' internationalization pace and pattern	Lindqvist (1988), Conviello and Munro (1995), Jones (1999)
Constraint firms' future scope and market opportunity	Conviello and Munro (1995)

Source: Zain M., Ng Imm S.: *The Impacts of Network Relationships on Firms' Internationalization Process*, "Thunderbird International Business Review", 2006, Vol. 48, No. 2, p. 188.

The research results lead to the conclusion that software firms from the study were highly dependent on network relationships in their initial decisions to internationalize, to develop an international market, and to support their marketing-related activities. This was particularly true for software SMEs. In contrast, manufacturing firm was not influenced by network relationships in all activities.

The researchers state that the study has some limitations. The main limitation was that the study focused on a single industry/sector (i.e. the software industry). Thus, according to the researchers it would be inappropriate to generalize the results too widely. However, the research context can be extended to other business sectors. Moreover, the proposed conceptual framework is an interesting proposal to investigate the influence of networks on SMEs' internationalization in different countries.

²⁰⁾ Coviello N.E., Munro H.: *Growing the entrepreneurial firms: Networking for international market development*, "European Journal of Marketing" 1995, vol. 29, no. 7.

5.4. The Uppsala Internationalization Process Model Revised

The Uppsala internationalization process model (chapter 4) was revised in the light of changes in business and theoretical advances made after 1977. The economic and regulatory environments have changed dramatically. Thus, the firm behaviour has also changed in many aspects. In the revised model Johanson and Vahlne develop different aspects influencing internationalization process of the firm (2009)²¹⁾. Their core argument was based on business network research and had two sides:

1. Markets are networks of relationships in which firms are linked to each other in various, complex and, to considerable extent, invisible patterns.
2. Relationships offer potential for learning and for building commitment, both of which are preconditions for internationalization.

The firm in the market environment: a business network view

A number of studies have supported the role of networks in the internationalization of firms. That is why, the researchers decided to develop further their model in light of such clear evidence of the importance of networks in the internationalization of firms. They focused on business networks as the market structure in which an internationalizing firm is embedded and on the corresponding business network structure of the foreign market. Research has proved that firms are frequently involved in a set of different, close and lasting relationships with important suppliers and customers²²⁾. As those firms are also involved in a number of additional business relationships, firms operate in networks of connected business relationship²³⁾.

The term connected means that exchange in one relationship is linked to exchange in another. These webs of connected relationships are labelled *business networks*.

Moreover, the firm may create new knowledge through exchanges in the network of interconnected relationships. Knowledge creation is the result of confrontation between producer of knowledge and user of knowledge. Thus a network of business relationships provides a firm with an extended knowledge base²⁴⁾. Relationship partners are a source of relevant business information about their own partners and more distant actors in the network. Thus the firm commands privileged knowledge about its business network.

A firm's success requires that it is well established in one or more networks. The researchers argue that anything that happens, happens within the context of a relationship, and a firm that is well established in a relevant network/networks is an "insider". It is to a large extent via relationships that firms learn, and build trust and commitment – the essential elements of the internationalization process.

A firm without position in a relevant network is an "outsider". If a firm attempts to enter a foreign market where it has no relevant network position, it will suffer from the

²¹⁾ Johanson J., Vahlne J.E.: *The Uppsala internationalization process model revised: From liability of foreignness to liability of outsidership*, "Journal of International Business Studies", 2009, vol. 40.

²²⁾ Hakansson H.: *Corporate technological behaviour: Co-operation and networks*, Routledge, London 1989.

²³⁾ Andersson J.C., Hakansson H., Johanson J.: *Dyadic business relationships within a business network context*, "Journal of Marketing" 1994, vol. 58, no. 4, pp. 1–15.

²⁴⁾ Hakansson H., *International marketing and purchasing of industrial goods: An interaction approach*, Wiley, Cheltenham 1982; Kogut B.: *The network as knowledge: Generative rules and the emergence of structure*, "Strategic Management Journal" 2000, vol. 21, no. 3, pp. 405–425.

liability of outsidership and foreignness. The status of outsider makes it impossible to develop a business and somehow the internationalization process begins (the learning process, and trust- and commitment building may begin).

In the view of the researchers, a firm's environment is made up of networks that influence the way firms learn, build trust, develop commitment and identify and exploit their opportunities.

Knowledge and learning

The original model (1977) was based on the assumption that knowledge is fundamental for firm's internationalization, especially that knowledge that grows out of experience in current activities is crucial to the learning process. Thus, learning by experience results in gradually more differentiated view of foreign markets as well as firm's capabilities.

During the last decades there has been a growing interest in organizational learning in general and in the internationalization context. More recent research has shown that more general internationalization knowledge (which reflects firm's resources and its capabilities for engaging in international activities) is also important²⁵⁾. The authors argue that the general internationalization knowledge concerning different several kinds of experience, including foreign market entry, mode-specific, core business, alliance, acquisition and other specific kinds of internationalization experience is more important than they assumed in 1977.

Given the business network view, they added to the "new" model the concept of *relationship-specific knowledge*, which is developed through integration between two partners, and that includes knowledge about each other's heterogeneous resources and capabilities. Moreover, knowledge development in business networks is different from the kind of knowledge they assumed in original model. In business networks the interaction between the buyer's user knowledge and the seller's producer knowledge may also result in some new knowledge.

Trust and commitment building

The original model did not include any affective or emotional dimensions in relationships. In the revised model the researchers explicit those dimensions. It is so because much has been written on social capital, trust and similar concepts, which include both affective and cognitive elements. They also argue that affective dimensions are very important for understanding the relationships that are a critical component of the "new" model. Moreover, trust plays an important role in recent research on relationship development²⁶⁾ (and business networks. Trust can also substitute for knowledge, for instance when a firm lacks necessary market knowledge. Trust encourages people to share information, promotes the building of joint expectations and is especially important in situations of uncertainty. It is also crucial in the early phases of relationship. Trust is a major determinant of commitment.

As far as commitment is concerned, Johanson & Vahlne argue that it is rather a question of more or less intensive efforts – when both commitment and trust – not just one or the

²⁵⁾ Eriksson K., Johanson J., Majkgard A., Sharma D.D.: *Experiential knowledge and cost in the internationalization process*, "Journal of International Business Studies" 1997, vol. 28, no. 2, pp. 337–360; Loustarinen R.: *Internationalization: Evolution of a concept*, "Journal of General Management" 1988, vol. 17, no. 3, pp. 333–334.

²⁶⁾ Johanson J., Mattsson L.G.: *International relations in industrial systems: A network approach*, in: N.Hood & Vahlkne (eds.), *Strategies in Global Competition*, Croom Helm, London 1988, pp. 468–486.

other – are present, they produce outcomes that promote efficiency, productivity and effectiveness.

Opportunity development

In the original model it was assumed that market commitment and market knowledge affect “perceived opportunities and risks which in turn influence commitment decisions and current activities. Since 1977 the field of opportunity research has grown significantly. Research on business networks and entrepreneurship has made considerable progress since they published their “old” model. Now they recognize that they probably neglected the opportunity dimensions of experiential learning.

The researchers now believe that by combining findings from the research with the business network perspective they can take a step forward in discussing opportunities in the internationalization process.

Thus, opportunity development is an interactive process characterized by gradually and sequentially increasing recognition (learning) and exploitation (commitment) of an opportunity, with trust being an important lubricant. It follows then that the process of opportunity identification and exploitation in the network perspective is very similar to the internationalization process and to the relationship development process.

The declining validity of the establishment chain

The researchers are aware of the fact that most of criticism of their “old” model was based on the observation that firm behaviour has changed since they built their model.

The concept of the establishment chain proposed by them implied that companies start to internationalize in neighbouring markets and subsequently move further away in terms of psychic distance, and also that in each market companies begin by using low-commitment modes, such as wholly owned subsidiaries. Some researchers who have observed company behaviour that deviates from the establishment chain of internationalization pattern have used these observation to criticize original internationalization process model. Now, Johanson and Vahlne argue that most changes in company behaviour have more to do with changes in international environment than with changes in internationalization mechanisms. Thus, network view, presented above, helps to explain deviations from the establishment chain.

A Business Network Model of The Internationalization Process

In the revised model internationalization is seen as the outcome of firm actions to strengthen network positions by what is traditionally referred to as improving or protecting their position in the market. As networks are borderless, the distinction between entry and expansion in the foreign market is less relevant, given the network context of the revised model. The traditional view of entry, that is overcoming different barriers, is now less important than internationalizing undertaken to strengthen a firm position in the network²⁷⁾.

As in the 1977 version model, the 2009 business network model consists of the two sets of variables: stable variables and change variables, or stock and flow, which are relevant to both sides of relationship. The variables affect each other, the current state having an impact on change and vice versa. Thus, the model depicts dynamic, cumulative process of learning, as well as trust and commitment building. An increased level of knowledge may thus have a positive impact on building trust and commitment. In the worst case sce-

²⁷⁾ Johanson J., Vahlne J.E.: *Business relationship learning and commitment in the internationalization process*, “Journal of International Entrepreneurship” 2003, pp. 83–101.

nario, which may actually not be so rare, the firm and/or the firm on the opposite side of the relationship may in fact reduce the commitment or even terminate the relationship. These processes can occur on both sides of a mutual relationship and at all points in the network in which the focal firm participates (fig. 2.1).

Although the basic structure of the model is the same as in 1977, some changes have been made. The authors added “recognition of opportunities” to the “knowledge” concept. Opportunities constitute a subset of knowledge. By adding this variable, they consider opportunities the most important element of the body of knowledge that drives the process. Other important components of knowledge include needs, capabilities, strategies and networks related firms in their institutional contexts.

The second state variable is labelled “network” position. This variable was identified in the original model as “market commitment”. Now, the authors assume that the internationalization process is pursued within a network. Relations are characterized by a certain level of knowledge, trust and commitment.

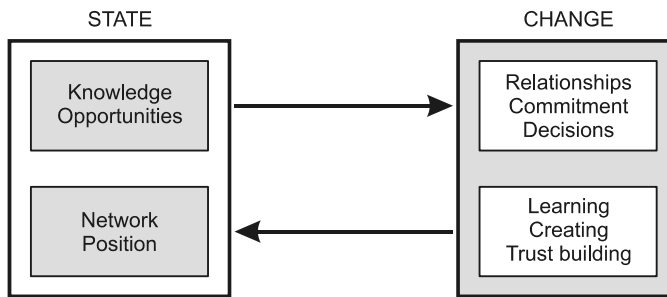


Fig. 5.2. The Uppsala internationalization process model revised:
from liability of foreignness to liability of outsidership

Source: Johanson J., Vahlne J.-E.: *The Uppsala internationalization process model revised: from liability of foreignness to liability of outsidership*, “Journal of International Business Studies”, 2009, vol. 40, p. 19.

As far as the change variables are concerned the researchers changed the original label of “current activities” to “learning, creating and trust-building” to make the outcome of current activities more explicit. The concept of current activities/operations in the original model was intended to indicate that regular daily activity play an important role and lead to increase knowledge, trust and commitment. The term “learning” is at the highest level of abstraction..

Finally, the other change variable, “relationship commitment decisions”, has been adapted from the original model. The researchers added “relationship” to clarify that commitment is to relationships or to networks of relationships.

There are some implications of the revised model for the internationalization process. First, internationalization of a firm depends on its relationships and networks. Thus, a firm goes abroad based on its relationships with important partners who are committed to develop the business through internationalization. These partners may be at home or abroad. According to the authors, there are two possible reasons for such foreign expansion:

1. The likelihood of finding interesting business opportunities.

2. When a relationship partner who is going abroad, or already is abroad, wants the focal firm to follow. By following the partner abroad, the firm demonstrates its commitment to the relationship.

The next issue is where an internationalizing company will go? The general answer of Johanson&Vahlne is: where the focal firm and its partners see opportunities. A foreign market in which the partner has a strong position is another possibility. This may be the first step abroad but also the same process may continue from market to market, depending on the actions of the focal firm's partners.

How might the process start? Given the business network model's process view, any determination of a starting point will be arbitrary²⁸⁾. Regardless of whether we consider the starting point to be the founding of the firm, the first international market entry, or the establishment of a specific relationship, the revised process model implies that explanation is in the state variables, such as knowledge, trust, or commitment to the firm's specific relationships.

²⁸⁾ Coviello N.E.: *The network dynamics of international new ventures*, "Journal of International Business Studies", 2006, vol. 37, no. 5, pp. 713–731; Reuber A.R., Fisher E., *The influence of the management team's international experience on the business behaviors of SMEs*, "Journal of International Business Studies" 1997, vol. 28, no. 4, pp. 807–825.

New Approach towards Internationalization of SMEs

6.1. The Holistic Approach to Internationalization

In chapter 4 internationalization was viewed as an export-led phenomenon and an incremental process. Firms start their international activity from “psychologically close” markets and then increase commitment to international markets in a gradual manner through a series of “stages”. The main critical remarks towards “stage models” stress that the ‘stage’ approach does not address the dynamic nature of internationalization.

In chapter 3, network approach was presented. This approach, in turn, concentrates on the market and the relationship of the firm to that market. According to the network approach internationalization is seen as a process in which relationships are continuously established, developed, maintained and dissolved with the aim of achieving objectives of the firm. The internationalization process of SMEs from network perspective has been intensively investigated during the last two decades and there is no doubt that networks play an important role when a firm enters foreign markets.

However, there is no doubt that internationalization is a complex and multidimensional phenomenon. All above presented perspectives are fragmented and generally focus on one aspect of firm international activities (the majority of the research focused on factors causing internationalization or on the process by which firms become increasingly international).

Moreover, internationalization is influenced by a number of factors. The attempts to integrate different approaches towards internationalization were started, for example, by Richard Fletcher who proposed a conceptual framework of a holistic approach of firm internationalization. The model presents three different forms of firms’ international activities: outward (e.g. export), inward (e.g. import) and linked (e.g. strategic alliances). These three forms are influenced by each other and they are also under the influence of internal and external environment.

Another integrative integrated approach towards internationalization was proposed by Bell et al. (2003). The researchers distinguished three different “pathways” of SME internationalization as well as three groups of SMEs: penetration of foreign markets incrementally (‘traditional’ firms), the rapid (fast pace) internationalization (“born globals”) and entering into foreign markets as “traditional” firms, but due to some incidence the pace of penetration becomes faster (born-again global).

Finally, the knowledge-based mode is presented¹⁾. The model includes “knowledge factors” i.e. market knowledge, experiential knowledge composed of network knowledge, cultural knowledge, and entrepreneurial knowledge. The model explains the role of knowledge in SME internationalization. Even though it is innovative, it is also deeply rooted in key entrepreneurial and internationalization paradigms²⁾.

Fletcher³⁾ states that although internationalization extends to other activities such as licensing and manufacturing overseas, it is usually considered from an “outward” perspective. However, a majority of firms also engage in “inward” and “linked” international activities as well as “outward” activities. Moreover, the factors that predict outward internationalization also predict “inward” and, to a lesser extent, “linked” internationalization. Fletcher questions the traditional view that internationalization is progressive and incremental. The researcher also pointed at the issue of de-internationalization and its role in the long-term internationalization of the firm.

De-internationalization is the opposite to stage progression. In both international and domestic markets firms often downsize, shed unprofitable operations and return to their core competencies and increase their outsourcing – all in the interest of enhancing their ability to compete in longer term. It refers to voluntary de-internationalization but it can also be involuntary when expropriation occurs in a foreign market. De-internationalization can take the form of reducing operations in a market, completely withdrawing from a market or switching to modes of operation that entail a lesser commitment of resources.

According to Fletcher, in response to ongoing changes in international environment, especially elimination of barriers in trade, more complex forms of firms’ international behaviour evolved. These forms of behaviour were influenced by the increasing need to serve customers in global economy, to bring products to markets more quickly, to introduce products into several countries simultaneously, to lower costs by focusing on firms’ core competencies and to reduce promotion costs by marketing globally under one brand.

At the beginning of the previous decade, the environmental changes required new approach that embraced more holistic view of internationalization. It assumed the following factors:

1. Firms can also become internationalised by inward-driven activities such as indirect and direct importing, becoming a licensee for a foreign firm, being the joint venture partner with an overseas firm in its domestic market, or by manufacturing overseas to supply the home market.
2. Outward internationalization can lead to inward internationalization and vice versa, as when the franchisee or licensee in one country becomes the franchisor or licensor in another.
3. Internationalization often requires more complex forms of international behaviour in which there is a linking of both inward and outward international activities as happens with strategic alliances, countertrade and cooperative manufacture.
4. Internationalization should be viewed as a global activity rather than as an activity with respect to firm’s involvement in a specific overseas country. This means that internationalization should not only focus on expansion of international involvement in

¹⁾ Mejri K., Umamoto K.: *Small- and medium-sized internationalization: Towards the knowledge-based model*, “Journal of International Entrepreneurship”, 2010, vol. 8, no. 2, pp. 156–16.

²⁾ Penrose, *op. cit.*, 1966; Johanson & Vahlne, *op. cit.*, 1977.

³⁾ Fletcher R.: *A holistic approach to internationalisation*, “International Business Review” 2001, vol. 10, pp. 25–49.

a particular country but also on contraction – a firm might also involuntarily reduce its involvement in one country in order to devote resources to more beneficial activities in other countries. This relates to the concept of de-internationalization proposed by Welsh and Benito (1996)⁴.

Figure 6.1. presents a conceptual framework of a holistic approach to internationalization. It shows that factors previously found to apply outward-driven internationalization also impact on inward and linked forms of internationalization. It also shows that outward forms of internationalization can lead to inward forms and vice versa. Moreover, it illustrates that linked forms of internationalization can be driven by outward forms (e.g. a desire to export) or by inward forms (i.e. a desire to tie up a long-term supply from overseas of a difficult-to-obtained product).

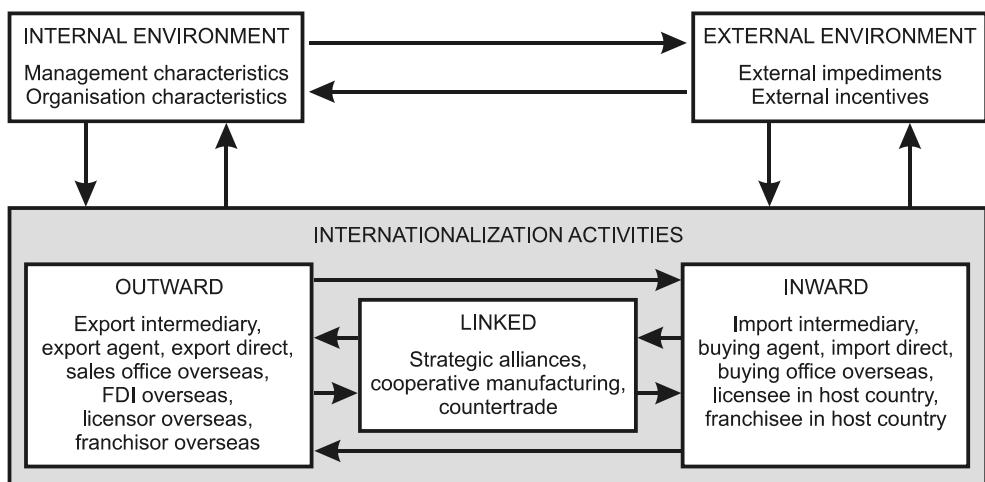


Fig. 6.1. A holistic approach to internationalization

Source: Fletcher R.: *A holistic approach to internationalisation*,
“International Business Review” 2001, vol. 10, p.30.

Factors causing internationalization

The management characteristics are demographic such as age and education and those involving aspects of international exposure such as country of birth, time spent living overseas and frequency of business trips overseas. Moreover, factors which reflect the knowledge of international business such as familiarity with culture and international business practices and international transaction experience. Other important characteristics include a structured approach to management such as planning orientation or having a strategic or proactive approach.

The most important organisational characteristics are willingness to develop products for overseas markets, technological advantage, willingness to fund international activities, size as measured by employment, willingness to reach overseas markets, focus on research development and the nature of product.

⁴) Welsh L., Benito G.R.G.: *De-internationalization*, Department of Marketing, University of Western Sydney, Nepean 1996, Quoted in: Fletcher R., *op. cit.*

The most important external impediments are marketing activities by competitors in overseas markets and perception of higher risk in overseas markets including lack of continuity in overseas orders, tariff and non-tariff barrier, exchange rate fluctuations, knowledge of market and how it operates, issues related to agents and control including attitudes of foreign governments, costs, lack of export training and government assistance.

The most important external incentives are availability of export incentives from government, overseas demand factors such as competitiveness and inquiries via industry bodies or government representatives overseas or information. Other include fall in domestic demand or excess capacity and reduction of production costs.

It should be emphasized that the integrative model was proposed at the beginning of the new millennium, almost a decade ago. At that time it seemed that a holistic approach to internationalization was better able to mirror the more sophisticated forms of firm's international activities. It was because, the number of firms that operated in global markets was growing. SMEs driven by global trends were often forced to form strategic alliances, enter into cooperative manufacturing arrangements, acting as both licensee and licensor or both franchisee and franchisor. In addition, the holistic approach was also a more appropriate description of the involvement of 'born global' SMEs, transnational firms undertaking international business in new, at that time, electronic environment.

6.2. The Integrative Model of Small Firm Internationalization⁵⁾

Another integrative integrated approach towards internationalization is presented in integrative model of Bell et al. (2003). The researchers presented three different "pathways" of SME internationalization. The first one is penetration of foreign markets incrementally ("traditional" firms), the second one is rapid (fast pace) internationalization ("born globals") and the third one is entering into foreign markets as "traditional" firms, but due to some incidence the pace of penetration becomes faster (born-again global).

The overall objective of the investigation was to better understand internationalization process of SMEs. The original aim was to explore and explain differences in pattern, pace and process of internationalization between three selected groups of firms. The research questions included:

1. The factor that motivated firms to internationalize.
2. Firms internationalization objectives.
3. The patterns and pace of internationalization.
4. Market entry and distribution strategies.
5. Strategic approaches to international marketing.
6. Methods of financing international expansion.

Investigated firms were drawn from a variety of industries including electrical and mechanical engineering, food and beverage, ICT s, printing and textiles. All were current exporters, employed less than 250 staff (over 90% had less than 100 employees) and were independent.

⁵⁾ Bell J., McNaughton R., Young S., Crick D.: *Towards an Integrative Model of Small Firm Internationalisation*, "Journal of International Entrepreneurship" 2003, no. 1, pp. 339–362.

There is no doubt that widely described in literature since the early 1990s. (chapter 2) “born global” firms undergo rapid internationalization. They internationalize from inception or start to shortly thereafter.

According to the authors of integrative approach, the main source of competitive advantage of the “born global” firms is often related to a more sophisticated knowledge base. Moreover, they found evidence of firms supporting this “born global” pattern of behaviour but also evidence of firms that suddenly internationalize after a long period of focusing on domestic market. These “born-again” globals appear to be influenced by critical events that provide them with additional human or financial resources, such as changes in ownership/management, being taken over by another company with international networks, or themselves acquiring such a firm⁶⁾. Thus, with their own results as well as extensive research literature review the authors proposed an integrative model that recognises the existence of different internationalization “pathways”. Then, they explored differences in behaviour due to the firm’s internationalization trajectory and discussed the strategic and public policy implementations.

The integrative approach describes the main differences in the internationalization, motivation and behaviour of “traditional”, “born global”, and “born-again global”. “Traditional” SMEs are usually much more reactive, they are often “pushed” into international markets by adverse domestic market conditions, unsolicited orders or the need to generate revenues to finance future product or process improvements. The “born global” firms have more committed management, pursue global “niches” from the outset and are generally more proactive. The “born-again” global firms’ sudden change of focus from a domestic to an international orientation is triggered by an infusion of new human and/or financial resources, access to new networks in overseas markets, acquisition of new product/market knowledge or some other critical incident.

Firms’ international objectives also differ. Traditional firms usually try to survive by increasing sales volume, greater market share or extending product life cycles. For “born global” firms the main goals are often to gain “first mover” advantage and achieve rapid penetration of global “niches” and segments. They also make attempts to protect and exploit proprietary knowledge and “lock-in” clients”. Moreover, often the pace of technological innovation leads to very short life cycles and narrow commercial opportunities of the firm. The researchers assume that for “born-again globals” the main objective appears to be to benefit from new networks and resources gained as a result of particular “critical episodes”.

Taking the above into consideration, the patterns and pace of internationalization of the three groups of firms are also different. “Traditional” firms tend to focus on domestic market first, expand incrementally, start internationalization process with “psychologically close” markets and/or target less developed markets. They often enter one market at a time and concentrate on a small number of key markets, adapting existing offerings to the needs of each new markets. In the case of “born global” firms, domestic and international expansion tends to be concurrent and internationalization may even precede domestic market activities. Firms are also often influenced by global industry trends, enter many “lead” markets simultaneously, undertake global product development and are not influenced by “psychic” proximity. Among “born-again global” firms each period of domestic market orientation is replaced by rapid and dedicated internationalization.

⁶⁾ *Ibidem.*

Moreover, among “born global” and “born-again global” firms there is stronger evidence of export or domestic client followership and of the importance of different kind of networking. In turn, “traditional” firms tend to adopt rather conventional approaches such as agents and distributors. In addition, “born global” and “born-again global” firms are more likely to integrate into clients’ existing channels (e.g. by adopting customer dealer networks or new networks provided by the acquiring or acquired partners). They are also more likely to set up licensing agreements or enter alliances.

Finally, the authors prove that “traditional” firms continue to be *more ad hoc*, reactive and opportunistic, whereas “born global” firms generally adopt much more structured approaches to internationalization. In the case of “born-global firms, strategies tend to be much more systematic once the decision to internationalize has eventually been triggered by a critical incident (table 6.2).

All these differences are incorporated in the integrative model of small firm internationalization that is proposed and discussed hereafter.

The normative, international model (fig. 6.2) is based on the extensive internationalization literature, incorporates much empirical enquiry into the process of “born global” firms and includes the researchers’ observations on the “born-again global” phenomenon.

Firstly, the three main trajectories shown in the model are intended to verify stereotypical internationalization patterns rather than rigid “pathways”. In practice, internationalization pathways are highly individualistic, situation specific and unique. Secondly, it is assumed that knowledge base of the firm is the source of competitive advantage and influences both the patterns and pace of internationalization. **Thus, firms with highly sophisticated knowledge bases tend to internationalize much more rapidly than firms with basic capabilities.**

As mentioned above, in the proposed model firms are classified as follows:

1. **“Traditional” firms** – those that follow incremental approach to internalization, are usually set up in their domestic markets before they start international activities (and often enter markets with increasing “psychic” distance). The “knowledge-based” element of offerings is usually not high in this group of firms although some quite sophisticated processes may be involved. Typically, neither processes nor products are particularly advanced.
2. **“Born global firms”** – may be further classified as either “knowledge-intensive” or “knowledge-based” firms. In both categories, firms can be defined as those **having a high added value of scientific knowledge embedded in both product and process.** The key difference between them is that “knowledge-based” firms exist because of emergence of new technologies (e.g. ICTs, biotechnology). They either develop proprietary knowledge or acquire knowledge, without which they would not exist (e.g. software firms, internet providers). In contrast “knowledge-intensive” firms use knowledge to develop their products, improve productivity, introduce new methods of production and/or improve service delivery. However, these firms are not inherently “knowledge-based”. These are, for instance, the users of computer aided design (CAD), computer aided manufacturing (CAM) or high-tech fabrics in clothing industry. “Knowledge-based” firms usually internationalize very rapidly. However, the pace of internationalization of “knowledge-based” firms may be determined by whether they are technological “innovators” or “adopters”. The former usually internationalize at a faster pace than the latter (in smaller open economies limited domestic market opportunities may also be a driver). **Nevertheless, in all cases, the knowledge-base can be regarded**

as a core competence and a source of competitive advantage. In the case of service-intensive firms, especially those involved in franchising and/or retailing operations, successful commercialisation first takes place in domestic market and then a firm starts its internationalization. Thus a firm may spend a longer period of time on domestic market on testing and developing the service offering for domestic consumption before starting rapid internationalization. Thus, the lag between start up and internationalization can be explained by the need to gain the requisite market knowledge and adapt service offerings and marketing strategies for foreign customers.

3. **“Born-again global”** manufacturing firms function more often in traditional industries rather than high technology sectors. However their knowledge intensity may increase with product and/or process development or due to new product and/or market intelligence acquired as a result of the critical incident. It happens, that this new knowledge is acquired through take over of another firm what in turn may accelerate internationalization pace. The term “born-again” is also applied to firms that have changed or modified their traditional business formats in order to internationalize via Internet. Thus the adaptation of product/market innovation, or the adoption of new information technologies may also be “drivers” of internationalization⁷⁾.

Table 6.1

Differences in Internationalisation Behaviour

Criterion	“Traditional” firms	“Born global” firms	“Born-again” global firms
Motivation	<ul style="list-style-type: none"> – Reactive – Adverse Home market – Unsolicited/enquiries orders – “Reluctant” management – Costs of New production 	<ul style="list-style-type: none"> – Proactive – Global “niche” markets – “Committed” management – Active search 	<ul style="list-style-type: none"> – Reactive – Response to “critical” incidents (MBO, take-over)
Objectives	<ul style="list-style-type: none"> – Firm survival/growth – Increasing sales volume – Gaining market share – Extending product life-cycle 	<ul style="list-style-type: none"> – Competitive advantage – “First-mover” advantage – Rapid penetration of global niches/segments – Protecting and exploiting proprietary knowledge 	<ul style="list-style-type: none"> – Exploit new networks and resources gained from critical incident
Expansion patterns	<ul style="list-style-type: none"> – Incremental – Domestic expansion first – Focus on ‘psychic’ markets – Low tech/less sophisticated targeted – Limited evidence of networks 	<ul style="list-style-type: none"> – Concurrent – Near-simultaneous domestic – And export expansion – Focus on ‘lead’ markets – Some evidence of client “followership” – Strong evidence of networks 	<ul style="list-style-type: none"> – “Epoch” on domestic market followed by rapid internationalization – Focus on ‘parent’ company’s networks and overseas markets – Strong evidence of client ‘followership’
Pace	<ul style="list-style-type: none"> – Gradual – Slow internationalization – Small number of markets – Single market at a time – Adaptation of existing offering 	<ul style="list-style-type: none"> – Rapid – Speedy internationalization – Large number of markets – Many markets at once – Global product development 	<ul style="list-style-type: none"> – Late/rapid – No international focus then rapid internationalization – Several markets at once

⁷⁾ *Ibidem.*

Continued Table 6.1

Criterion	"Traditional" firms	"Born global" firms	"Born-again" global firms
Method of distribution/entry modes	<ul style="list-style-type: none"> – Conventional – Use of agents/distributors or wholesalers – Direct to customers 	<ul style="list-style-type: none"> – Flexible and networks – Use of agents or distributors – Also evidence of integration with client's channels, use of licensing, joint ventures, overseas production etc. 	<ul style="list-style-type: none"> – Networks, existing channel/s of new "parent", partner/s or client/s
International strategies	<ul style="list-style-type: none"> – Ad-hoc and opportunistic – Evidence of continued reactive behaviour to new opportunities – Atomistic expansion, unrelated new customers/markets 	<ul style="list-style-type: none"> – Structured – Evidence of planned approach to international expansion – Expansion of global networks 	<ul style="list-style-type: none"> – Reactive in response to "critical" incident but more structured thereafter – Expansion of newly acquired networks
Financing	<ul style="list-style-type: none"> – "Boost-strap" into new markets 	<ul style="list-style-type: none"> – Self-financed via rapid growth – Venture capital – Initial public offering (IPO) 	<ul style="list-style-type: none"> – Capital injection by "parent" – Refinancing after MBO

Source: Bell J., McNaughton R., Young S., Crick D.: *Towards an Integrative Model of Small Firm Internationalisation*, "Journal of International Entrepreneurship" 2003, vol./no. 1, pp. 346–347.

The integrative model is also based on the following assumptions:

1. The model acknowledges views on knowledge intensity as a major source of competitive advantage. Knowledge intensity may stem for greater proprietary knowledge in terms of product or service offerings, new design, development and production process, technological innovations, adoption of e-business solutions etc. It may also be influenced by greater knowledge of global industry sector and of "niche" markets for offerings.
2. The model recognises that the small firm internationalization process is neither linear nor unidirectional. The use of term "state of internationalization" in the model is intended to reflect the potential for forward and backward momentum. This "state" is contingent upon prevailing external environment conditions, the availability or absence of human and financial resources within the firm. Firms may experience "epochs" of internationalization, followed by periods of consolidation or retrenchment, or they may be involved in "episodes" that lead to rapid international expansion or de-internationalization. Also, some events may encourage firms to focus on the domestic market. These "episodes" or "epochs" may be triggered by forces that have impact on the internationalization strategies of domestic or overseas customers and other network partners.
3. The proposed model states that **"no single theory appears to have sufficient explanatory power on its own"**⁸⁾. The model incorporates dimensions of extant incremental 'stage' theories and network perspectives. It also accepts explanatory value of contingency approaches and allied resource-based theories. By integrating elements of the above approaches, the intention is to seek to provide a coherent perspective of small firm internationalization.

⁸⁾ *Ibidem*, p. 352.

4. Finally, the main thrust of the integrative model is to focus on strategic rather than operational issues. It is intended to provide a basis for development of prescriptive models that will contribute to managerial decision-making and address issues relating to the financing of international operations. The model also offers perspectives on policy formulation and implementation in support of small firm internationalization. It assumes that nature and level of firms' support needs vary across different internationalization "pathways" or trajectories.

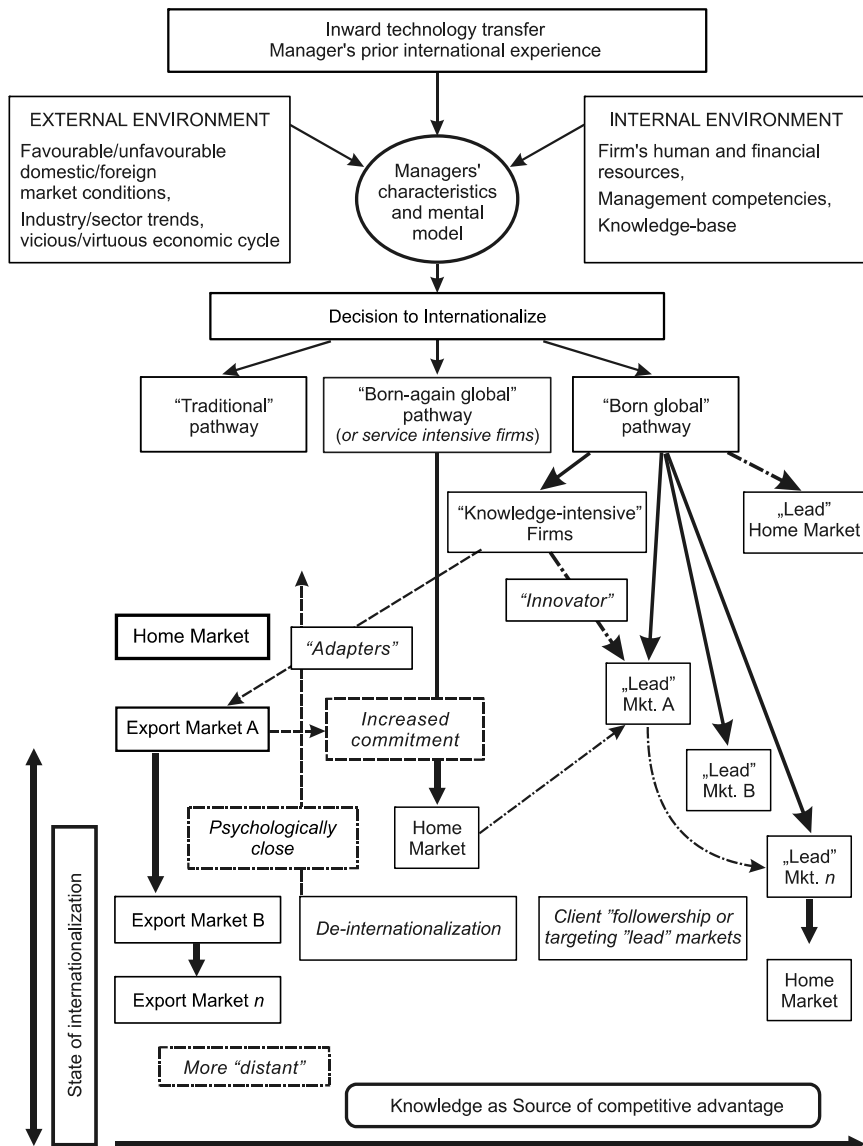


Fig. 6.2. An integrative model of small firm internationalization

Source: Bell J., McNaughton R., Young S., Crick D.: *Towards an Integrative Model of Small Firm Internationalisation*, "Journal of International Entrepreneurship" 2003, vol. 1, p. 350.

Managerial implications

Different internationalization trajectories described in the integrative model also allows for some useful insights into firm's internationalization strategies, especially the means of financing international operations.

Firms following the "traditional" pathway are likely to "bootstrap" into international markets using revenues generated from the domestic market and/or from the initial steps into foreign markets and any support they can obtain from the government sources to finance international expansion. Indeed, an unsatisfactory outcome at any stage may delay the internationalization process or even result in subsequent de-internationalization. In addition, lack of capital may lead to a slower pace of internationalization.

In the case of the firms following "born global" trajectory, they often try to gain first-mover advantage by internationalizing rapidly into "lead" markets. This requires involving significant product and market development costs. If firms successfully penetrate a large "lead" market (which might include the home market) they may have sufficient revenues to expand rapidly into other markets. As a result they may need to seek venture capitals. It may also happen that a firm would be taken over by a larger domestic or international player. That, in turn, may provide a firm with the capital to set up a new venture. Moreover, once 'born global' firms have eventually opted to pursue internationalization strategy, they may be in a better position to finance rapid internationalization expansion. They may have also gain a substantial infusion of human and financial resources, proprietary knowledge or international marketing expertise following an acquisition, as result of having been taken over, or due to another critical incident.

The "born-again" trajectory is also more likely to be adopted by service-intensive firms in retailing, leisure, and hospitality, because of tendency towards direct and more costly modes of investment or for franchisers who need to develop and "prove" the business concept in the domestic market before starting international expansion. However, rapid internationalization is unlikely to take place until concept and quality of service delivery are proven in the home market and can be culturally adopted.

The choice of internationalization trajectory also influences the choice of firms, business strategies and the resources they must acquire. For instance, the management of human resources will vary according to internationalization pathway.

The integrative model also formulates some proposals for public policy for SME internationalization. Many national Export Promotion Organisation (EPO) strategies should focus on supporting this sector. The specific goals of them should be:

- 1) to develop a broad awareness of export opportunities and to stimulate interest among the business community;
- 2) to assist firms in planning and preparation for export market involvement;
- 3) to assist firms in acquiring the needed expertise and know-how to successfully enter and develop export markets;
- 4) to support foreign market activity tangibly through organisational help and cost-sharing programmes⁹⁾.

The integrative model of SME internationalization stressed differences in process, patterns, and pace among "traditional", "born global" and "born-again" global firms. The model accepts and incorporates different aspects of process and network theories in order to

⁹⁾ *Ibidem*, p. 354.

gain a broader view on small firm internationalization. Elements of contingency approaches and resource-based theory are included, especially in the “born-again global” pathway. In attempt to integrate these diverse, yet complementary, perspective, this contribution support previous calls for more holistic approaches to research in this field. It was the authors’ intension to seek to move the small firm internationalization research agenda forward to enable enquiry to focus on specific and important issues of internationalization. In particular, much greater enquiry is required into ways in which firms can leverage additional external financing, acquire and exploit knowledge, improve the resources of human capital and enhance their networking capabilities. The researchers acknowledge the existence of multiple internationalization “pathways” but they also admit that internationalization process of individual firm is specific and unique; their study identifies a number of stereotypical pathways a firm may follow.

6.3. The Knowledge-Based Models of Internationalization SMEs¹⁰⁾

The model includes “knowledge factors” i.e. market knowledge, experiential knowledge composed of network knowledge, cultural knowledge, and entrepreneurial knowledge. The model is an innovative proposal that allows to understand the role of knowledge in SME internationalization.

The authors argue that there is an important need for a new perspective to explain firm internationalization. As already explained, internationalization is a phenomenon influenced by many factors like decision making, network, firm characteristics, culture, environment etc. The scope of the knowledge-based model is one particular and not all the markets in which the firm is involved in. The level of experience: pre-internationalization (no experience), novice internationalization (short experience), and experienced internationalization (long experience) was proposed as criteria for the phases. The model consists of three phases during which four kinds of knowledge are involved in these phases (fig. 4.3). These phases are the pre-internationalization, the novice-internationalization phase, and the experienced internationalizing phase. The border between novice internationalizing and experienced internationalizing is difficult to delineate and therefore the authors did not make a clear separation between them.

It should be also explained that that the knowledge-base view of the firm was considered as an extension of the resource-based view (see chapter 2). Let’s remind again that the resource-base view is originated from the work of Penrose¹¹⁾ about the growth of the firm. She focused on the firm internal resources, especially the productive services available to a firm from its own experienced management.. In turn, Barney¹²⁾ focused on heterogeneity of resources among firms and stability of these differences over time, explained the sustainable competitive advantage by the firm resources. The resources are valuable, rare, imperfectly imitable and sustainable.

During the 1990s, the knowledge-based view of the firm emerged. Within this stream, knowledge constitutes the most critical resource for existence and development of a firm. In

¹⁰⁾ Mejri K., Umemoto K.: *Small- and medium-sized internationalization: Towards the knowledge-based model*, “Journal of International Entrepreneurship”, April, vol. 8 nr 2, 2010.

¹¹⁾ Penrose E.T.: *The theory of growth of the firm*, Blackwell, Oxford 1966.

¹²⁾ Barney J.B.: *Firm resources... op. cit.*

knowledge-based model, the choice of knowledge perspective was explained by mainly three reasons. First, SMEs compared with big firms have relatively less resources that makes knowledge very important for firm survival and growth. The lack of tangible resources should be compensated by intangible resources, that is knowledge. Second, knowledge has always been the core of human competences. Building on this, the researchers perceive internationalization as a consequence of knowledge. Third, it has been found that knowledge is crucial for understanding SME internationalization.

Market knowledge

As it has been explained, market knowledge refers to objective or explicit information about foreign markets e.g. market size, the competition, the regulations. Market knowledge is usually acquired by the firm during the pre-internationalization phase and it is critical for internationalization start and its first phase. As for example explained in U-model (chapter 4), market knowledge is a starting point of internationalization.

The knowledge-base model assumes that the intensity of use of market knowledge decreases as the firm progresses in the internationalization.

Experiential knowledge

Experiential knowledge is regarded as the essential for firm internationalization. This type of knowledge results from practice and “can only be learnt through personal experience”¹³⁾. Experiential knowledge includes network knowledge, cultural knowledge and entrepreneurial knowledge. In the model it is perceived as a triad of these above mentioned types of knowledge. The acquisition of experiential knowledge starts in the pre-internationalization stage and continues when the firm starts its internationalization.

Network knowledge

Network knowledge involves both social and business networks. In the model, network knowledge refers to the network itself (as the locus of knowledge). Network knowledge acquisition starts in the pre-internationalization stage and continues during the novice internationalization phase. It is used in different phases of internationalization. However, the degree of use of network knowledge is different in particular stages. It has been proved that network built in pre-internationalization stage was critical for internationalization start. The network can force and encourage firms to further internationalization (see: chapter 3).

Cultural knowledge

Cultural knowledge of a foreign market refers to the knowledge of values, manners and ways of thinking of people in that market. The acquisition of cultural knowledge starts with the beginning of internationalization. The firm gradually knows how to behave from a cultural perspective, with partners in the foreign markets. The utilization of this knowledge increases together with its acquiring. During the novice-internationalization stage, there is a low intensity of utilization of cultural knowledge. Later, it may grow to high intensity when a firm becomes more experienced in a foreign market. The authors of knowledge-base model accept that psychics distance is important when choosing a foreign country to enter in.

¹³⁾ Penrose E.T., *op. cit.*

Entrepreneurial knowledge

Entrepreneurial knowledge refers to knowledge of the existence of opportunities and how to use them. Opportunity recognition and its exploitation continues in many cases the reason behind the internationalization of the firm. The opportunity recognition ability and its exploitation are acquired from the start of the firm. During the novice-internationalization phase, the firm gradually applies the acquired opportunity recognition and exploitation ability.

To conclude, the knowledge-base model is a step added to stage models and it perceives internationalization from a knowledge perspective.

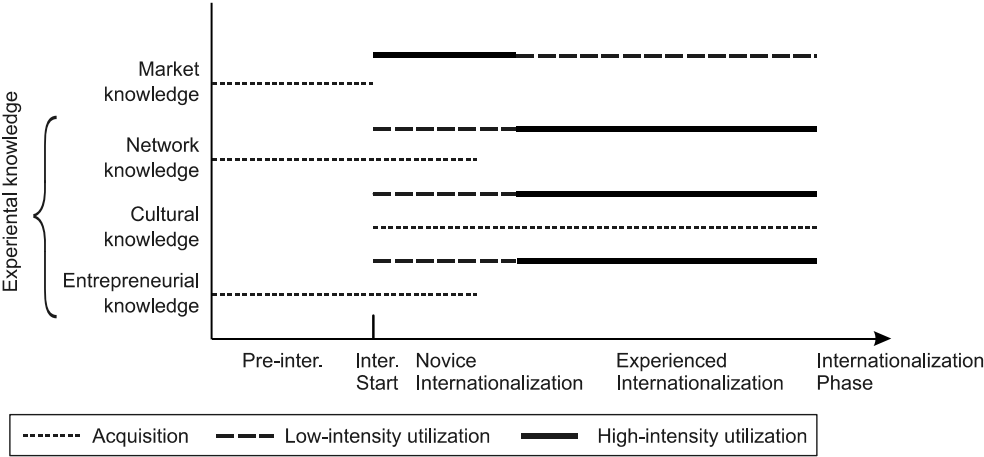


Fig. 6.3. A knowledge-based model of SME internationalization

Source: Mejri K., Umemoto K.: *Small- and medium-sized internationalization: Towards the knowledge-based model*, “Journal of International Entrepreneurship”, 2010, vol. 8, no. 2, p. 162.

Conclusions

It has been proved that SMEs are important players in contemporary economies. They are dynamic, flexible and adapt quite easily to changing economic conditions. It is very important, especially within the actual global financial crisis and the increase of global competition.

There is no doubt, that the continuous processes of internationalization and globalization mean both chances and threats for SMEs. Chances exist in the abilities to make use of all existing possibilities, which are created by ongoing processes. Businesses should search for their competitive advantage by the implementation of the internationalization, Europeanization and even globalization strategy. Entries on foreign markets can improve the position of a business on the market. It is because a firm is getting access to international competence and resources technologies, know-how and business relations. Moreover, the willingness to adjust to global competition requires new activities which often lead to **growth** of a firm.

It is crucial that the possibilities, which are created for European businesses by the process of political and economic integration in the frame of the European Union, including Europeanization of business activities, will be fully used.

Small and medium-sized enterprises in contrast to large enterprises are less likely to globalize their activity, but ongoing process of integration and globalization makes it different. Almost 20 years ago, Naisbitt formulated a global paradox stating that “the bigger global economy is, the stronger are the smallest players”¹⁾, which still seems to be valid. Drucker confirmed it stating that more and more economic units, including small firms, operates as transnational companies (*micronationals*)²⁾. According to the OECD data in 1995 about 20–25% of small and medium-sized enterprises were involved in any kind of international activity, of which only 1% were reported to be global firms. What is more, the forecasts for the year 2005 assumed that about 1/3 of SMEs would be involved in any international activities. According to the European Commission in 2009 just 44% of EU-27 SMEs were involved in any international activity³⁾.

Even though, many SMEs still function on local and domestic markets, the content of this book leads to conclusion that growing number of them is becoming international and few of them even global⁴⁾.

¹⁾ Naisbitt J.: *Global Paradox*, Routledge Publishing, London 1995.

²⁾ Drucker P.: *Introduction: Towards the New Organization* Published in: *Organization of the Future*, eds. Hasselbein F., Goldsmith M., Beckhard, Jossey-Bass Bennis, San Francisco 1994.

³⁾ *Internationalisation of European SMEs. Final Report*, European Commission & EIM Business, Zoetermeer – Brussels 2010.

⁴⁾ Daszkiewicz N.: *Konkurencyjność MSP w procesie międzynarodowego* [w:] Daszkiewicz N. (red.) *Konkurencyjność. Poziom makro, mezo, mikro*, Wydawnictwo Naukowe PWN, W-wa 2008, s. 119–136.

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