

# A Preliminary Assessment of Croatian SME Exporters' Internationalization: Is There a Gap?

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## Abstract

This paper deals with an analysis of the internationalization process of Croatian SME exporters. The traditional theory of internationalization suggests that a firm gradually develops an international presence. Internationalization process can be divided into two aspects: attitudinal (orientational) and strategic action.

Preliminary research was conducted in two stages. First the findings from secondary data analysis suggest that Croatian SME exporters are oriented towards regional markets. Also, the notion that size of the company significantly determines the number of the export markets that the firms serves has been confirmed in the Croatian setting as well as in a previous research. Secondly, the primary research indicates that Croatian SME exporters are showing significant signs of geocentric behavior (through the global mindset scale) but yet most of their exports are reaching the countries in region mostly. This gap represents an interesting research proposal for further future investigations within the internationalization phenomenon.

## Introduction

The internationalization has been subject of many studies in international marketing (business) literature. SME Internationalization is relatively new phenomenon in international business and marketing research (Lu, & Beamish, 2001; Bell, Mcnaughton, Young, & Crick, 2003; Lu, & Beamish, 2006). Its conceptual domain is placed within the traditional scope of gradual stages model (Johanson & Valhne, 1977; Cavusgil, 1980; Johanson, & Valhne, 1990). Main premise of the stages model is that the firms internationalize phase by phase, upgrading orientation and business strategies as firms' international involvement evolves. In Croatian context, there has not as yet been much of the research in the area of internationalization (as well as factors which influence it, and are result of it), especially in the SME sector. It must be noted that the internationalization, from the strategy viewpoint, is of the crucial importance for the SMEs. While expansion into new geographic markets presents an important opportunity for growth and value creation, the implementation of such a strategy involves many unique challenges in addition to the common ones associated with the domestic growth of SMEs. Exporting has been traditionally regarded as the first phase to entering the international markets, serving as a platform for future international involvement (Kogut, &

Chang, 1996). This strategy is particularly applicable to the internationalization of SMEs because the SMEs frequently lack the resources, for direct investment (Dalli, 1995; Zahra, Neubaum, & Huse, 1997).

Therefore, the organization of this paper is as follows: First, the contextual domain of SME internationalization is defined, alongside with the factors influencing it, and resulting from it. Second, the EPRG framework is used to determine the attitudinal (orientation) aspect of internationalization and to determine its theoretical fit (and to offer possible redefinition) in a SME context. Next, the secondary data analysis is conducted in order to see the pattern and scope of international involvement in internationalization process of SMEs in Croatian context. Parallel to this, the primary research is conducted to determine the level of global orientation and to see whether there is a balance between the strategy and orientation of SMEs. Results from (im)balance are discussed and possible factors (barriers) affecting this state are identified. Finally, limitations are discussed and a possible further research directions within the Croatian context are suggested.

### **Theoretical background of SME Internationalization**

Internationalization presents involvement process of business activities in the international arena. Research in the area of internationalization is rooted in the work of Perlmutter and Heenan (1975) who had discussed the strategic alternatives of MNEs which are involved in complex international business activities. This approach was based on the analysis of attitudes (orientation) which MNE adopts and latter was upgraded by the aspect of strategic market planning (Chakravarthy, & Perlmutter, 1985). As the result of these efforts, the EPRG model was developed in which the MNEs are divided into the strategic groups based on attitudinal (orientational) level (ethnocentric, polycentric, regiocentric and geocentric). Recent research in the domain of internationalization theory was focused on integration of various aspects of this theory such as the RA (Resource Advantage), TCA (Transaction Cost Analysis), Eclectic, and Network theory (Malhotra, Agarwal, & Ulgado, 2002). This was because all of these theories, as a standalone, could not provide complete analytical framework to address the internationalization phenomenon. Internationalization does not occur instantly; moreover the firm goes through a several stages (incremental steps) of involvement as identified by the Uppsala model (Johanson, & Wiedersheim-Paul, 1975; Johansson, & Vahlne, 1977; Cavusgil, 1980). Second mode, which is categorized in a traditional theory of internationalization, is innovation model. It is based on Roger's adoption process and proposes that the internationalization is an outcome of learning process during the involvement in the international market operations (Bilkey, & Tesar, 1977). Whatsoever, traditional models of internationalization have been subdued to a major criticisms in the international business academia because they were made to fit for MNE in the first place. However, as noted before, nowadays we have intense penetration of SMEs is evident, and in most economies (as well as in Croatia), SMEs represent more than 90% of industrial structure. As Anderson (1993) observed, more and more SMEs are directed towards international markets without a phase by phase process proposed by the traditional stages model. As today more and more SMEs are penetrating onto the international stage seeking possibilities for a growth and profit, there is a great obligation and importance to overview the possible distinctions and similarities between the behavior of MNEs and SMEs. As a result, SMEs have more distinct antecedents and a theoretical basis for internationalization so it is necessary to apply the separate analytical approach. On the other hand, researchers are more and more familiar with the born global concept (Oviatt, & McDougall, 1994). Contemporary international marketing (business) literature has applied the "born global" concept in the case

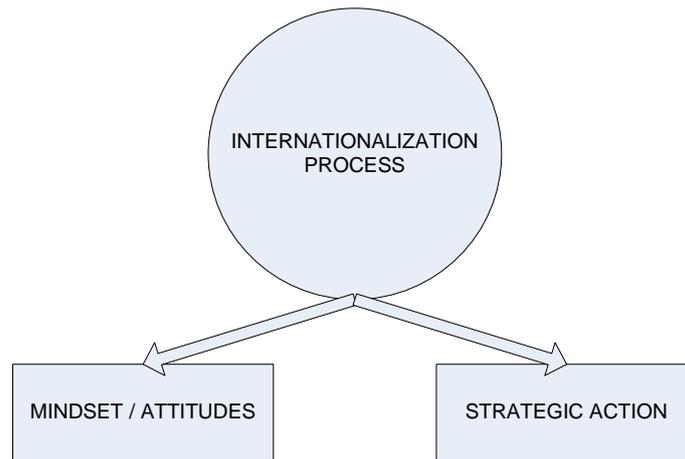
of SMEs. A main premise of this model is that firms enter international markets soon after the firms' inception and they are not, however, dependent on the domestic market (Moen, & Servais, 2002). International business academia has several times criticized the stages model because of its deterministic approach, and many research results do not provide evidence of firms fitting in the conceptual foundations of stages model (Oviatt, & McDougall, 1994).

Moreover, SMEs follow somehow turbulent approach to internationalization so it is justified to define the "state of SME internationalization" rather than the "stage of SME internationalization" (Bell, Mcnaughton, Young, & Crick, 2003). This is because most of the SMEs directly after an establishment, export their products/services abroad. Literature and research has identified the ICT sector as the most propulsive one in which SMEs act by the "born global" pattern (France, & Collins-Dodd, 2000). SMEs fitting into the "global born" domain observe the world as a one global marketplace. The concept of "born globals" deviates from traditional theories of internationalization. Initially, they seek opportunities on the worldwide basis taking the advantage of development on new ICT technologies which in the end have an impact on the standardization of marketing strategy. This approach facilitates the new look on the international markets, not as the option because of limitations in a domestic market. Rather it is an opportunity to improve the overall business performance.

### **EPRG framework implementation in the SME context**

Internationalization has rather different approaches which the "born global" pattern clearly described. EPRG is the most comprehensive model that explains the attitudes in internationalization which was developed in order to classify the MNEs by various indicators (Perlmutter, 1969; Heenan, & Perlmutter, 1979; Chakravarthy, & Perlmutter, 1985). MNEs are classified into four different attitudinal (orientational) stages: ethnocentrism, polycentrism, regiocentrism and geocentrism. Modern approach to the internationalization pinpoints that operatively, concept should be divided into two sections: strategy (action) and attitudes (orientation) (Chetty & Campbell-Hunt, 2004). Giving the distinction between the strategic action and orientation proposed by Chetty and Campbell-Hunt (2004), it is necessary to delineate the functionalism and role of each as the important components of the internationalization process. Strategy refers to the actual business activities that firm conducts in the international market (regarding the value proposition through marketing mix; level of standardization or adaptation). An orientational aspect is linked with mindset and attitudes that export managers (or general managers) have toward international market expansion (See Figure 1.).

**Figure 1.** The two aspects of internationalization process



Specifying an internationalization process construct in this way gives an opportunity to define the state of balance between the two aspects of internationalization. Suppose that firm operates in several countries and its managers have a global orientation. In this manner we have disproportion between the strategic action and orientation, because it is evident that firm operates clearly just on several international markets and its managers perceive the world as a one global market and are eager to expand globally. Set of the export manager's attitudes represents central role of the internationalization process dynamics. Earlier, Schuch (2007), stressed that orientational aspect is somewhat predecessor of strategic action regarding the MNEs internationalization. Crucial fact is that SMEs, operating from a home country base, can have some characteristics of a global orientation. The main question that arises is whether the components of internationalization (mindset and strategic action) are balanced? Parallel to this, additional question arises: Does the size of the firm influence the number of the export markets that a firm serves. All this questions are inevitably reconsidering the structure and dynamics of the internationalization process, and whether such conceptual and recent research basis fit into Croatian context. As Bell, Mcnaughton, Young, & Crick (2003) delineated, the central point of the internationalization process must be the orientation (attitude) of decision maker which is thereafter followed by the formulation of international market strategy. On the other hand, if the orientational diversification that SMEs posses nowadays, is assumed, it is possible to overlook that within a formulation of the international business strategy (and its dynamics), SMEs do not follow traditional pattern of MNEs. This reason is a product of a fact that most of the SMEs still consider and use the export strategy as a main strategic option when expanding into the international markets. Most SMEs do not upgrade to a more complex modes of entry which may be contributed to a several obstacles which literature pinpoints: lack of resources, insufficient international market knowledge, lack of export promotion programs and psychic distance. However, besides current approach, it can not be unmentioned that most of the SMEs operate in many countries and in this way develop a global orientation. Following this, it is possible to assume that these business decisions (regarding the international market expansion) are a product of the mindset and cosmopolitanism (Madsen, & Servais, 1997) that export decision maker possess. So it is righteous to define that the attitudes are prerequisite for the strategic action aspect of internationalization process. Therefore, the global orientation (as well the other orientations) is not exclusively a characteristic of MNEs, as it is stressed in the mainstream international business theory (Rugman, & Verbeke, 2008). Global marketplace is open for the SMEs which demonstrate tendency and skills to offer unique value proposition on the global basis. The justification to apply the EPRG framework in the SMEs context can be considered appropriate and valid although SMEs rarely upgrade their international market entry modes. Export still stands as

the main strategy that SMEs embrace rather because of the earlier mentioned barriers that limit them in advancing onto more complex modes of entry. Classical proposition of the EPRG framework insists on the number of factors which serve in order to divide the firms into four substantive categories. Probably the most important of these factors include the level of complexity in entry mode and HRM questions such as management and leadership in international affiliations (for more detailed overview see Schuh, 2007).

Following the results of the research several discussion themes arise in Croatian SME context. Schuh (2007) in his qualitative research has identified possible three factors which support the regional strategy of MNEs and could be well applied into SME context: geographic proximity, transition process and the stage of market development. Precisely, regional orientation within MNEs strives to rationalize the costs of market entry organizing the one focal point of centralized coordination and management within a region. On the contrary, SMEs, although having the regional market reach and orientation, lack the resources for the direct investment and operate their regional (or global) operations from the home country base. However, the SMEs rely on the relationship with foreign exchange partners (importers, trading companies, etc.) and tend to create an international business network which would boost the long-term business activities. Table 2 gives the main distinctions between the regioncentric MNEs and SMEs.

**Table 1.** Distinctions between regiocentric orientation in MNE and SME

<b>Distinction</b>	<b>SME</b>	<b>MNE</b>
<b>Organizational structure</b>	Centralized within a home country	Global or regional headquarters – communication with worldwide subsidiaries
<b>Management and leadership</b>	Solely domestic management	Regional or global professionals
<b>Relationships within system</b>	International network partnering	Regional and global vertical integration
<b>Agency problem</b>	Owner, is in the most of the cases, a general director	Conflict between headquarters and subsidiaries

A good example of regiocentric MNE is the large Slovenian retail chain Mercator. Mercator has established subsidiaries within region in countries such Croatia, Serbia and Bosnia and Herzegovina. Each of these subsidiaries has general managers from that country (regional professionals). Mercator uses the similarities among the markets of ex-Yugoslavia and offers a standardized retail concept. Moreover, considering the previous analysis it can be noted that Mercator fits well into the regioncentric block of the EPRG framework. Besides the differences, main similarity between SMEs and MNEs is the attitudinal (orientational) aspect of internationalization which strictly identifies and endorses the region as a homogenous market entity. Similarities that homogenize the region, clearly attract Croatian SME exporters to embrace such an opportunity and to offer a distinct value proposition in these markets.

## **Methodology**

The research was conducted in two steps. First, the secondary data was analyzed in order to explore the pattern, scope and level of internationalization through exports in Croatian SME export sector. Moreover, these data was used to reveal the strategic action aspect of the internationalization process of Croatian SMEs. Second, the primary data from questionnaire was used to explore and identify the attitudinal aspect of Croatian SMEs by determining the level of global mindset that export manager possesses. Research is exploratory in nature because there were no earlier research efforts addressing SMEs internationalization agenda in Croatian context.

### Secondary data analysis

For the purpose of this analysis, the Croatian Exporters Database 2007 (provided by the Croatian Chamber of Economy) was thoroughly examined. First step was to identify the small, medium and large exporter firms who clearly identified their export markets as well as percentage of total exports for each and one of them. Total population comprised of 576 companies (from which 490 were SMEs and these population was used latter for survey research to identify the global mindset level of SMEs).

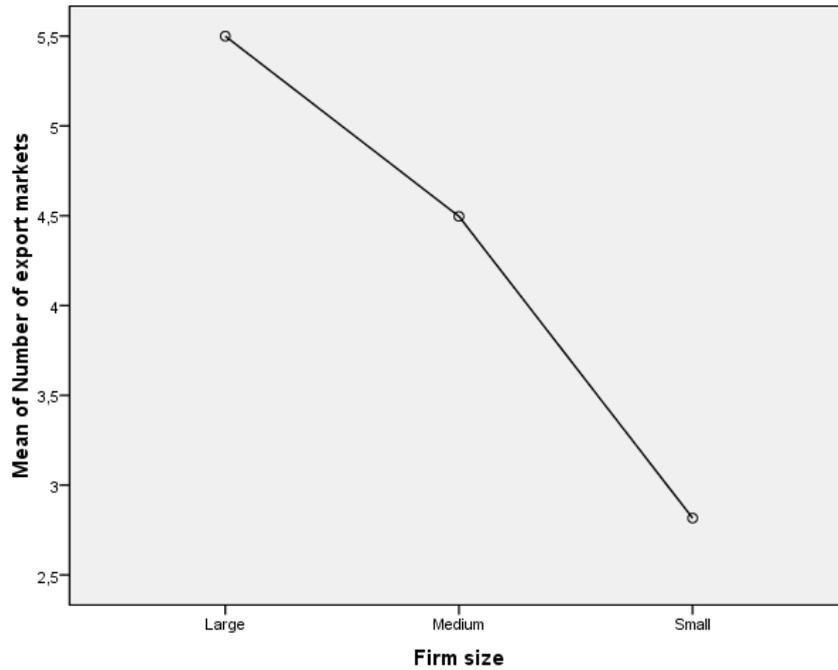
### Findings

The results clearly indicate that there is correlation between the size of the firm and the number of export markets that it serves which was confirmed in earlier research (Beamish, Goerzen, & Munro, 1983; Balcome, 1986; Calof, 1993). However, it would be methodologically unjustified to generalize this rule because some research results didn't find positive connections between firm size and a number of export markets that it serves (France and Collins-Dodd, 2000; Mcnaughton, 2003). ANOVA test (See Table 2. and Figure 2.) confirmed that in Croatian context there is a significant difference between the small, medium and large sized companies regarding the number of export markets they serve. Smaller number of served export markets indicates that SMEs are probably lacking resources to involve themselves more in the global markets. In this case they strive to maintain a good market position in markets in which they are present at the moment.

**Table 2.** Results of ANOVA test (Firm size and the number of Export Markets Served)

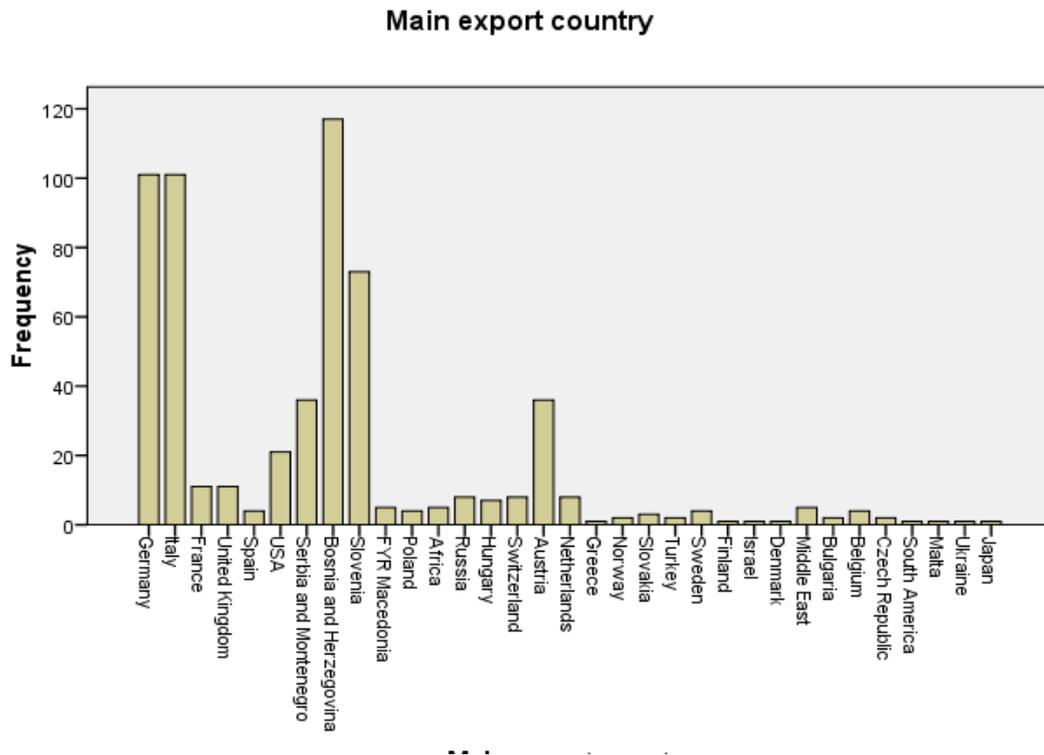
<b>ANOVA</b>					
<b>Number of export markets served</b>					
	<i>Sum of Squares</i>	<i>df</i>	<i>Mean Square</i>	<i>F</i>	<i>Sig.</i>
<i>Between Groups</i>	602,114	2	301,057	51,534	,000
<i>Within Groups</i>	3417,552	585	5,842		
<i>Total</i>	4019,667	587			

**Figure 2.** Firm size related to the number of export markets served



Research results regarding lead export market, confirm that the most common markets of Croatian SMEs are also a biggest international trading partners identified in the trade balance. In order to determine the scope of internationalization, one must examine are there any patterns that can be identified (See Figure 3.). The percentage of regional activity of Croatian SMEs is of around 40%. Regional activity is assumed to be the share of exports in countries in the region (Bosnia and Herzegovina, Serbia, Montenegro, Slovenia, and FYR Macedonia). This is a high share regarding the total cumulative percentage of all exports by SMEs. However, it must be noted that the regional activity is in the boundaries of ex-Yugoslavia. These countries share same history, cultural traits, language similarities and memberships in the same trading blocs. This evidence provides the background to discuss that Croatian SMEs embrace the opportunities that regional macro environment offers. Therefore it is justified to talk about the regional strategy of Croatian SMEs as a dominant strategic action pattern. Evolutional pattern of internationalization refers to a step by step international involvement. Regarding the results from Croatian context, it is proper to imply that the Croatian SME exporters are acting in the line with traditional stages model of internationalization.

**Figure 3.** Main export markets of Croatian SMEs



Several traditional internationalization theories (Dunning 1973; Johanson, & Wiedersheim-Paul 1975; Johanson, & Vahlne, 1977) suggest that, psychic or cultural distance, geographic distance, and market size have had a major impact on the target country selection. Johnson and Tellis (2008) propose that cultural distance is one of the vital factors influencing the entry timing and strategy in Indian and Chinese market.

### Primary data analysis

Primary data was obtained through the questionnaire which was used to gather the data also for the purposes of another study. As it was stressed before, the population used for survey research comprised of 490 SMEs. Key informants inside the firms were identified and the mail was addressed to their name. 54 mails didn't reach the address because the firm was no longer at that location, was acquired by another firm or didn't exist anymore. The response rate resulted in 70 of completed questionnaires (effectively 16%) which in the end represents a good response rate because there was no additional mailing or follow-up telephone contact and that the nature of the research is dominantly exploratory.

### Operationalization of global mindset

During the preliminary stage of the primary research process, it was necessary to determine the way in which it would be justified to measure the attitudinal (orientational) component of an internationalization process. The literature reveals that the most common used concept for measuring orientation is global mindset. Global mindset can be operationalized in many ways regarding the unit of analysis (Levy, Beechler, Taylor, & Boyacigiller, 2007). However, having in mind the nature of this research, researcher felt that it would be appropriate to use the measure of global mindset on individual level. This was so

because the key informants inside the SMEs were identified so it seemed justified to use this measure which was empirically tested by Nummela, Saarenketo, & Puumalainen (2001).

### Findings

Results are shown in Table 3. in which all statements in a scale are presented and for each and one there is a mean and standard deviation. As it is evident, Croatian SMEs are demonstrating high levels of global orientation through global mindset. Linking from the results from secondary data analysis, it must be noted that certain gap between attitudinal (orientational) and strategic action components of the internationalization process exists. These results pinpoint that Croatian SMEs could not be classified as a born global firms because their market involvement is on the regional level. In contrary, born global firms internationalize globally just after they are founded (McDougall, Shane, & Oviatt 1994; Moen, & Servais, 2002; Oviatt, & McDougall 1995; Rennie 1993). In this way they are able to synchronize the both components of the internationalization process.

**Table 3.** Level of global mindset adopted by Croatian SME exporters<sup>1</sup>

<b>Global mindset of Croatian SME export managers</b>					
	N	Minimum	Maximum	Mean	Std. Deviation
<i>It is important for our company to internationalize rapidly</i>	70	1	5	<b><u>4,13</u></b>	1,115
<i>Internationalization is the only way to achieve our growth objectives</i>	70	1	5	<b><u>3,90</u></b>	1,157
<i>We will have to internationalize in order to succeed in the future</i>	70	1	5	<b><u>4,11</u></b>	1,161
<i>The growth we are aiming at can be achieved mainly through internationalization</i>	70	1	5	<b><u>3,90</u></b>	1,229
<i>The founder/owner/manager of the company is willing to take the company to the international markets</i>	70	1	5	<b><u>4,37</u></b>	,981
<i>The company's management uses a lot of time in planning international operations</i>	70	1	5	<b><u>3,90</u></b>	1,038
<i>The company's management uses a lot of time in planning international operations</i>	70	1	5	<b><u>4,06</u></b>	1,306

<sup>1</sup> 5-point Likert scale questions (Anchors: 1- Totally disagree, 5- Totally agree).

## Discussion and implications

Dividing the internationalization process on the two distinct, yet cause related components, helps easily to spot the gap between them in the SME context. The will and desire to be more involved in the international markets (measured by attitudinal dimension of global mindset) is somewhat limited with the objective reality in which Croatian SMEs are forced to focus their strategies just in the region. The most possible limitation factors influencing such gap could be:

- 1) Physic distance
- 2) Unawareness of export promotion programs
- 3) Lack of resources

Earlier literature has postulated that in traditional model of the internationalization process firms assume that entering into new markets is a function of their psychic distance. Moreover, psychic distance was identified as determinant of the international market selection. Thus, psychic distance is a significant deterrent to market entry, at least in the initial stages of a company's international business development and particularly in the case of SMEs (Cicic, Patterson, & Shoham, 1999). Foremost, this viewpoint suggests that Croatian SMEs have been forced to focus initially on regional markets of ex-Yugoslavia. The ICT development is surely one positive factor that could avoid those barriers making it easy for firms to compete in a global marketplace by enhancement of the new logistical realities, especially for the service-driven firms. Regarding this factor, it can be discussed that the success of born global firms nevertheless is a result of embracing such opportunities, especially in ICT sector. Relating to the Croatian SME context, it must be explicitly said that physic distance is a vital factor that influences the firms to expand in their nearby countries before eventual global engagement. This notion fits well in the traditional theory of internationalization.

Export promotion programs (EPP) have been granted special position in the international business research (Seringhaus, & Botschen, 1990). Earlier research regarding this influencing factor showed that SMEs awareness and satisfaction on EPP was very low (Albaum, 1983; Walters, 1983; Denis, & Depelteau, 1985; Kedia, & Chhokar, 1986). The gap between the attitudinal and strategic aspect of internationalization could well be the outcome of this factor because SMEs are not aware of the opportunities and benefits that such programs offer. RBV perspective is explaining the process of generating and developing the scarce resources in order to leverage the sustainable competitive advantage (Barney, 1991; Grant, 1991). Resources, in the context of internationalization should be classified as the factor which has a profound implication on the intensity, scope and timing of the internationalization process. As the most SMEs deals with the lack of resources (especially for the purposes of the export strategy development), there is a nuisance to reveal the way in which this barrier can be overcome. One of the solutions is in the usage of the export promotion programs which are institutionalized. Domestic market provides resources for SMEs to internationalize through exporting activities. This is why it must be imposed that larger firms might have greater success than smaller firms in internationalization process. First, larger firms have recourse to more resources or can commandeer more resources than smaller firms (Bonaccorsi 1992). Dhanaraj & Beamish (2003) found that RB factors such as firm size and technological intensity are good predictors of the SME's export strategy.

## **Limitations and suggestions for further research**

As this paper addresses, the Croatian SMEs fit well into a traditional stages model of the internationalization process. Traditional stages model suggest that firms gradually (step by step) advance their international market presence. Whatsoever, SMEs (most of them) can not be expected to advance in internationalization process by establishing an overseas production. Export still represents the main mode of entry for the SMEs, however the perspectives of export must be embraced. SMEs should focus on the possibilities of international networking and relationship development with foreign partners (e.g. importers, trading companies, distributors, etc.). Research in the area of exporter-importer relationships are more than ever in the focus of contemporary international marketing (business) research and must not be neglected (Veludo, Macbeth, & Purchase, 2004; Leonidou, & Kaleka, 1998; Haugland, 1998). Attitudinal dimensions, measured through a global mindset, refer to a fact that Croatian SME exporters are largely interested in a global market presence. Despite this willingness, there is a strong background (in the sense of lack of resources, physic distance and export promotion) which limits the actual scope of their international market strategy. In this sense, the regionalization of strategy becomes natural and evolutionary stage in which Croatian SMEs orientate on culturally and physically close markets. On the whole, the research has number of limitations. Exploratory design is merely able to capture all the cause related relationships among the international business constructs of high interest. However, it clearly defines the background for further research efforts in the Croatian SME context. Law-like generalizations regarding internationalization phenomena are impossible and it would be methodologically trivial to embrace the generalizations as there are industrial, institutional and country specific factors that influence the pattern, scope and time dimension of the internationalization process. So the objective of this research was to open the new agenda regarding the SME internationalization in Croatian context. Most likely areas would be the influence of the attitudinal aspect on export performance and export market orientation. These casual models would indeed acknowledge the impact of an attitudinal aspect on performance. As well, the role of psychic distance, export resources and export promotion programs could be thoroughly examined as a contingency factor which would classify the firms by its impact on export performance.

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