

EXTERNAL SOURCES OF RISK IN SME INTERNATIONALIZATION – SELECTED ASPECTS

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Abstract

Internationalisation of enterprises in pursuance of geographic expansion has a positive impact on their competitiveness on both international and domestic markets. This process is one of the greatest challenges of all businesses, regardless of their size. However, for small and medium-sized enterprises with limited financial capital this issue is particularly testing. The cost of risk, defined as a predictable loss associated with the company's failure, may amount to discontinuation of the business abroad, or even contribute to bankruptcy. The foreign political, economic, technological and socio-cultural environment is a source of potential threats. Therefore, it is particularly important to identify as many risks as possible and manage them efficiently. The aim of the article is to present the results of the authors' own research carried out in 2017 on how entrepreneurs perceive external sources of risk related to the process of SME internationalisation. The research concerned gathering of information by entrepreneurs in creating their development and risk management strategies as well as preferences related to the choice of directions of geographic expansion. The results are based on 317 group administered questionnaires among respondents representing various industries in Poland in 2017.

Keywords: risk-taking, internationalisation, directions of internationalisation, SME

JEL Codes: D81, F23, F62

Introduction

The internationalisation of enterprises is usually associated with geographical expansion into international markets. The relevant literature offers many different, and often inconsistent, definitions of this process. Some researchers describe 'internationalisation' in quite vague terms, such as an increase in international activity, while others focus only on selected elements, referring to this process as, for example, building one's own position in relations with business partners (Johanson & Mattsson, 1988, p. 309). The authors represent what seems to be the most universal view in relation to all enterprises and entrepreneurial attitudes: that internationalisation is any kind of economic activity undertaken by an enterprise abroad.

Expanding abroad increases the risk of failure due to certain barriers. Therefore, it only makes sense to examine the foreign environment. According to T.L. Wheelen and J.D. Hunger, scrutinising the environment triggers subsequent stages in the process of enterprise development: formulation and implementation of strategies, followed by performance monitoring (Wheelen & Hunger, 2011, p. 101). The aim of the article is to present the results of research on how external sources of risk related to the processes of SME internationalisation are perceived by entrepreneurs in relation to the preferred directions of foreign expansion. The considerations were based on the authors' own research and supported by the literature on the subject.

Methodology

The research was carried out using a group administered questionnaire. The questions were formulated on the basis of available source texts and own research. The questionnaire contained 3 open questions and 12 closed questions, allowing respondents to either choose one of the answers or answer on a five-point Likert scale. Due to the purpose of the publication, which was the identification and assessment of the perception of external sources of risk associated with the processes of SME internationalisation, only selected elements of the PEST method were used in the research. The analysis excluded technological factors, which are less important for SME managers as businesses from this sector, despite their growing presence in technology, are still mainly focused on wholesale and retail trade (OECD, 2000, pp. 2-3). This is confirmed by the persistently low employment growth in technologically innovative areas among SMEs (European Commission, 2017, p. 35).

1 Role and importance of SMEs

Small and medium-sized enterprises are the basis of all modern economies. They have a direct impact on all micro- and macroeconomic indices as evidenced by recorded GDP increases and the number of people employed in this sector. Their role and importance are widely discussed in the literature, although they still face significant credit discrimination, as defined by Galbraight in 1957.

The source of financing has always been the main determinant of the sector's development. Enterprises of this size rely mainly on equity and limit their external liabilities to a minimum. They also tend to choose trade credit, or various forms of leasing or factoring, before they resort to additional sources of financing (Małecka, 2016, pp. 91-122).

This barrier directly affects their development and expansion rate. Contemporary enterprises, in wanting to ensure constant growth, should follow the principles of market competitiveness and flexibly adapt to the changing economic environment. Therefore, the decision to go international is strategic and should be considered not in terms of “whether”, but of “how and when”. This also applies to the SME sector and their internationalisation processes.

2 Types of risk and internationalisation models

Internationalisation is one of the greatest challenges of all economic entities, especially those with limited resources allocated to identifying potential threats in foreign markets. The related development opportunities and the possibility of generating higher revenues are subject to a significant risk of loss compared to solely domestic operations. In the case of SMEs, the consequences of insufficient information or incorrectly estimated risk may weaken their activity and hinder the development process, and, in extreme cases, contribute to their collapse. It is, therefore, particularly important to identify as many risks as possible and manage them efficiently. The relevant literature proposes different taxonomies of threats related to business activity. The classification most commonly used for the internationalisation process divides risks according to their source into: (1) external, or macro- and mesoeconomic, risks, and (2) internal, or microeconomic, risks (Krupa, 2002, p. 24). The degree of each factor’s influence depends, to a large extent, on the country in which the business is carried on, while adequate identification of sources of threats allows to avoid them, or minimise their effects. In this respect, being able to identify and accurately assess the risk is as important as eliminating it altogether. It is crucial that this process is of better quality than the competitors’ and result-focused (Kasperkowiak, Małecka & Łuczka, 2017, pp. 395-396). The changing nature of threats prevents their actual identification and has a direct impact on trade (Łuczka, Małecka, 2016, pp.116-125; Małecka, 2017).

Internationalisation, regardless of its model and form, requires the commitment of financial capital. This corresponds directly to the risk management process, which can be an additional difficulty in the initial period of the company’s operation. Until the end of the twentieth century, the theory of enterprise internationalisation was dominated by staged models, treating internationalisation as a process that is sequential and evolves over time. Each subsequent stage meant greater involvement in international activities, which was related to the increase in the invested financial capital. This is known as the ‘international-by-stage’ model (Oviatt & McDougal, 1994, pp. 45-64). The most popular staged model is the Uppsala model,

according to which there are four consecutive stages (sporadic export, export via a representative, establishment of a foreign sales subsidiary, and foreign production). This positioning enables entrepreneurs to make decisions regarding the pace of the internationalisation process and gradually increase the degree of risk (Johanson & Wiedersheim-Paul, 1975, p. 307). Another internationalisation concept, which is the opposite of staged models, is the creation of presence on foreign markets at the time of establishment of a business. Enterprises applying this approach, known as ‘born global’, gain faster and wider access to foreign markets than companies following staged models. However, they are more vulnerable to the risk of failure and related consequences, which for SMEs may mean complete elimination from the foreign market, and even bankruptcy (see also: Małecka, 2016, pp. 91-122).

3 External sources of risk in geographic expansion of SMEs – selected aspects

One of the main barriers to the development of SMEs mentioned in the literature on the subject is the source of financing, which can be considered a secured determinant if the enterprise had started to operate. In that case, the key task of entrepreneurs involved in internationalisation is to gain knowledge about the threats present in foreign markets, and incorrect interpretation of data is considered one of the major reasons for the risk of bankruptcy. Only 5 out of 8 enterprises of this size survive in the modern turbulent economic environment.

A helpful tool in the analysis of macro-environment is the PEST¹ method, which enables determination of its impact on the organisation (Stonehouse et al., 2004, p. 81). Its underlying assumption is to focus attention only on the study of the macro-environment of the company, which makes this method imperfect and incomplete for the purpose of obtaining information by entrepreneurs. For this reason, the results of PEST analysis are usually supplemented by the use of the SWOT² heuristic technique, which provides a comprehensive analysis of the determinants of the economic situation. SWOT also takes into account the micro-environment, which defines the structure and strength of local competition, as well as gives a more insightful

¹ PEST (also known as PESTLE, PESTEL, PESTLIED, STEEPLE, SLEPT and LONGPESTLE) – (an acronym from the fundamental factors in the organisation’s environment: Political, Economic, Social and Technological), a method of studying the macro-environment, referred to as general segmentation of the environment. It enables an analysis of the environment that has a key impact on the functioning of the company.

² SWOT – a method used to analyse the internal and external environment of the organisation. The information obtained may be used while creating the company’s strategy.

view of local conditions and weaknesses of the company in the analysed area. Other methods of macro-environment examination include: (1) extrapolation of trends, (2) analysis of the strategic gap, (3) the scenario method, (4) the Delphi method, or expert assessment.

3.1 Political, legal and economic environment of enterprises

An unstable political setting may discourage investors and the company from expanding into foreign markets. Similar entrepreneurial attitudes can be observed in a situation of uncertain regional policy, which can be an additional source of risk to foreign investors (Solingen, 2001, p. 524). Political risk is equated with government attitudes, which may affect the entire economy or only selected sectors. The political and legal system have an impact on the risk related to running a business in a given country. The activities of governments can take various forms and result in changes in legal and tax jurisdiction, customs restrictions to the inflow of foreign goods and services, and even expropriation of companies. This is a particular hindrance for SMEs due to their limited resources and poorer ability to identify the conditions in foreign markets and the resulting risks. The following published reports and indicators concerning various regions of the world are a valuable source that can be a starting point for expanding knowledge in this area: (1) Global Peace Index (GPI) and Global Terrorism Index (GTI) from the Institute for Economics and Peace (IEP) in Australia, (2) Legatum Prosperity Index (LPI) – an annual ranking developed by Legatum Institute based in London, (3) Fragile States Index (FSI) – an annual report published by the Fund of Peace in the US, (4) World Governance Indicators (WGI) – a World Bank programme covering selected actions of national governments, including political stability.

Another source of information about global markets may be the following published risk maps: (1) a map of terrorism and political risks prepared by Aon³ in cooperation with Roubini Global Economics⁴ and Risk Advisory Group⁵, and (2) the political risk map published by Control Risk, a British company which researches the factors that create risk in particular regions of the world.

Internationalisation creates prospects for expanding markets and increases the competitiveness of companies. Foreign market activity requires an examination of the economic environment and selection of the appropriate strategies (Eden, Dai & Li, 2010, pp.

³ Aon – a global services firm providing a broad range of risk solutions.

⁴ Roubini Global Economics – a global economic and financial analysis firm.

⁵ Risk Advisory Group – a global risk management consultancy.

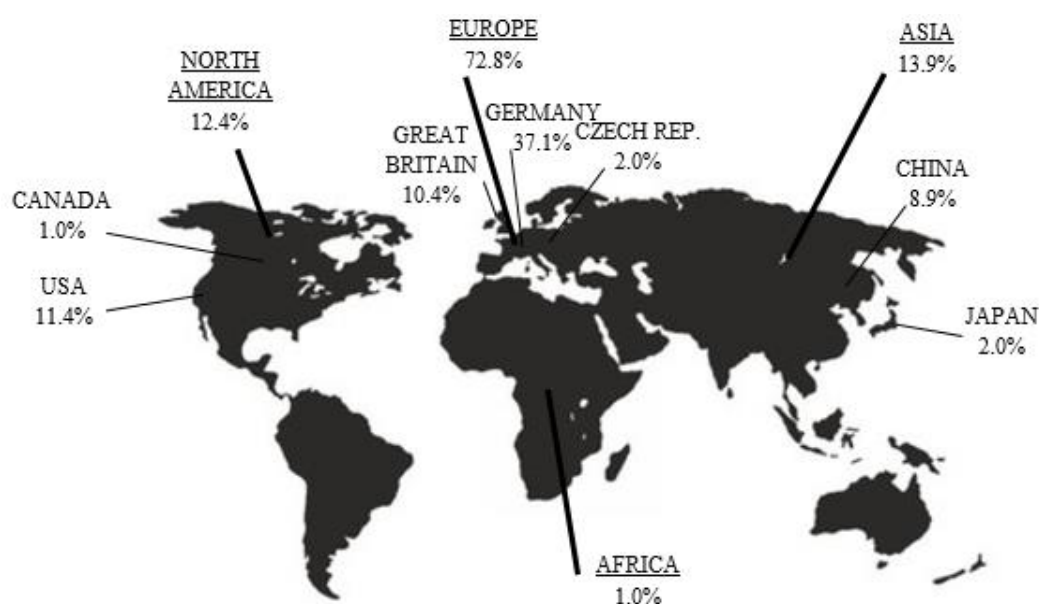
54-68). This allows identification of hazards and risk assessment when starting and running a business. The basic factors of macroeconomic analysis include the level of economic development measured by the gross national product and its change over time, the possible return on capital, inflation, exchange rates, unemployment and employment rates, as well as the level of indebtedness. A decline in GDP related to the recession, which is manifested by a decrease in demand, leads to price depression and, ultimately, to the intensification of competition. Foreign market sales depend on many internal factors of the relevant economy, and the preceding research of the economic environment is aimed at identifying and selecting the company's strategy and minimising the risks to achieving a competitive advantage. The adaptation of companies to activity in conditions of risk allowed to create varied paths of internationalisation over the years (Williams et al., 2014, p. 137). Entrepreneurs are offered support in the form of information programmes, which provide an overview of the relevant economy and are developed by governmental or non-governmental organisations, e.g. programmes of the Polish Investment and Trade Agency: "Go Africa", "Go China" and "Go India". These publications contain basic information about the political system, macroeconomic factors, suggested industries to collaborate with, as well as possible legal forms of conducting business abroad (PAIH, 17.05.2017).

4 Risks of internationalisation in the light of empirical research

The research on SME internationalisation was carried out in January and February 2017. The study covered 317 Polish respondents (49.8% women and 50.2% men) from the area of Wielkopolska who carry on their own business, or are planning to establish their own enterprise in the future. The respondents represented many industries, trading or providing services in foreign markets based on various forms of internationalisation. The size of the research sample made it possible to determine how risk was perceived in the internationalisation process by the respondents in Wielkopolska compared to the entire country. The selected Polish region is characterised by the highest ratio of the number of SMEs (2.3) per 1,000 inhabitants (Polityka Insight, 2015, p. 5).

In terms of the risk associated with internationalisation, the respondents were asked about their preferences regarding the choice of place of business. The low risk of geographic expansion in the EU area was reflected in respondents' opinions on the potential and security of conducting operations in particular geographic regions (Figure 1).

Fig. 1: Preferred regions of geographic expansion in the internationalisation of SMEs [%]



Source: Own research

Assuming the criterion of division of the economy on a global scale, the majority of the respondents considered European markets as the most prospective and least risky (72.8%). In this group, most opinions favoured the economies of EU countries (62.4%), and especially the German economy (37.1%). The number of supporters of other European countries was definitely smaller. The respondents were also positive about Asian countries (13.9%), including China (8.9%) and Japan (2.0%), as well as about North America (12.4%), with a preference for the United States (11.4%). Africa (1.0%) received the least support from the respondents in terms of economic potential and security of doing business. Other geographical regions were not indicated by the respondents.

The results of the research on the attractiveness of individual economies are confirmed by Poland's exports and imports in recent years. For SMEs, the geographic directions of foreign trade in products indicate a greater focus on exports to, rather than imports from, EU markets. More than three-fourths (77.4%) of all exports are to EU countries, and a quarter (22.6%) to other countries, while in the case of imports the difference in favour of EU markets is smaller: two-thirds (69.6%) to one-third (30.4%) (PARP, 2017, p. 26; Łuczka, Małecka, 2017, pp.116-125; Małecka, 2017)

In reference to external sources of risk, the respondents were asked to indicate the significance of risk factors related to operating outside their home country (Table 1). The European market had been divided into two areas: (1) the European Union and (2) other

economies without specifying country names. The opinions of the respondents indicate that political factors constitute a key source of risk in general (77.9%). In particular, this applies to non-EU countries (36.2%) and the Middle East (27.4%).

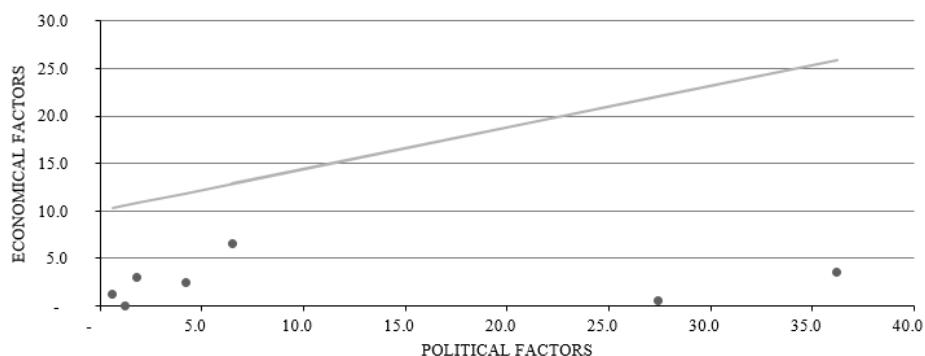
Tab. 1: Structure of external risk sources in correlation with their place of occurrence – weighted average [%]

COUNTRY/AREA	RISK FACTORS		
	POLITICAL	ECONOMIC	SOCIO-CULTURAL
EU COUNTRIES	6.5	6.5	0.6
EUROPE – NON-EU	36.2	3.6	0.6
MIDDLE EAST	27.4	0.6	3.6
ASIA	4.2	2.4	0.0
AFRICA	1.8	3.0	0.0
NORTH AMERICA	0.6	1.2	0.0
SOUTH AMERICA	1.2	0.0	0.0
TOTAL	77.9	17.3	4.8

Source: Own research

Economic (17.3%) and socio-cultural (4.8%) factors were perceived by respondents as less significant. This may be a confirmation of a lower level of education and lesser ability to correctly interpret the available economic indicators on both macro- and microeconomic levels among SME owners. The value of the Pearson coefficient for the conducted studies shows a weak positive correlation ($r=0.07$) between political and economic factors (Figure 2). This means that in the process of SME internationalisation, the economic risk increases slightly with the increase of political risk.

Fig. 2: Linear correlation between political factors and economic factors [%]



Source: Own research

The respondents' answers regarding economic determinants draw a picture of threats resulting primarily from strong economies and competition – the highest rating was given to EU countries (6.5%) and then the remaining European countries (3.6%). In the opinion of the respondents, the economy of South America is not a source of economic risk (0.0%). It can be assumed that respondents had rated this market as not very competitive or not very prospective in terms of foreign investment. The analysis of the research shows that socio-cultural factors are an insignificant source of risk in the internationalisation of enterprises and apply almost exclusively to economies associated with the terrorist threat rather than cultural differences, namely Middle Eastern countries (3.6%). The value of the Pearson coefficient indicates in this case a moderate positive correlation with political factors ($r=0.62$), and a weak negative correlation with economic factors ($r=-0.21$). This indicates that socio-cultural risk increases as political risk increases, but decreases as economic risk increases.

Conclusion

International activity is always more risky than activity in the domestic market. However, the modern entrepreneur does not ask “whether” but “how and when” they should go international. Correct risk identification and management should be a permanent element of corporate strategy, preceded by an analysis of the political, legal, economic and socio-cultural environment, which is often forgotten by the managers of SMEs.

As a result of the research, the authors observed that in terms of political, legal, and economic sources of risk, non-EU countries are perceived as more risky by the respondents. According to the authors, the reasons for this can be the extensive media coverage that focuses on European economies. Economic factors are a secondary source of external risk, most often understood as competitiveness. Furthermore, it was also noticed that according to the respondents cultural differences between individual countries do not constitute barriers to the internationalisation process.

The conclusions of the research are controversial and partly contradictory. When it comes to internationalisation of enterprises, respondents prefer European markets, while, at the same time, indicating them as the highest risk locations. This may indicate a certain acceptance of knowable risk, and therefore willingness to choose it over the uncertainty associated with the more remote and less known continents. This raises a question about the awareness and level of education of SME managers in relation to effective implementation of the

internationalisation processes, which opens up new opportunities for research and expanding knowledge in this area.

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