How can Small and Medium-sized Enterprises (SMEs) compete in their Domestic Market in a Globalized World?

Por Dr. Christian Keen

The international business environment is still changing dramatically and, although international growth may introduce added complexity it may be unavoidable for small and medium-sized enterprises (SMEs) mainly due to the increasing globalization of markets (Levitt 1983) and industries (Yip 2003). In the face of rapid globalization, SMEs are a vital part of the economic systems of both emerging and developed countries. As Veloso (1991) points out, this type of companies may be an important organ for increasing the level of competitiveness of emerging markets. Some studies, for example, Yasuf (2001), go to the extent of suggesting that growth and employment in developing countries depend on the fate of SMEs. The incentive and the legal structures within which firms must operate have been drastically altered. SMEs are no longer protected from foreign competition and local buyers and suppliers are becoming more sophisticated. To compete effectively, SMEs must adapt and reshape themselves to facilitate adjustments and enhance learning for their growth and economic development.

This article provides a typology to explain the degree of internationalization of SMEs. At one extreme is *tangible internationalization,* which is short-term and depends on macro and microeconomics factors exogenous to firms; at the other is a combination of *tangible and intangible internationalization*, which implies a strong commitment by firms to become competitive at international levels.I argue that different forces have forced the internationalization not only of firms, but also of markets, so that SMEs can become global without a physical presence in foreign markets. Furthermore, it may be necessary for these companies to become global if they are to remain competitive in their local markets. As a result of this paradigm shift, internationalization is based not only on geographical aspects, which are closely related to firm internationalization, but also on intangible considerations, which are closely related to market internationalization.

Tangible internationalization is a restricted approach defined as a physical presence in a foreign market; it consists mainly of foreign sales, foreign direct investment (FDI), physical presence in foreign markets, and foreign suppliers. It fluctuates with exchange rates, costs of inputs, and other resource endowments that are tied to a particular geographic location. On the other hand*, intangible internationalization* implies a change in the comprehensive approach to the way firms should reconfigure, develop and secure resources. Intangible internationalization requires facilitating learning at all levels of a firm to increase the stock of knowledge, and, therefore, to improve flexibility on the production side and increase the likelihood of developing new resources and processes, thus enhancing the firm's critical invisible assets (Itami and Roehl 1987). An SME should aim for both in order to take advantage of a physical presence in foreign markets and provide constant incentives to facilitate learning and new organizational capabilities and processes. Tangible internationalization is a short-term expansion in foreign markets because it takes advantage of temporary macro- and microeconomics conditions; it does not require changes at the firm level. On the other hand, a combination of intangible and tangible internationalization has a higher probability to be sustainable in the long term and mostly depends on the firm's actions to meet international standards.

This article emphasizes 5 crucial aspects of that managers need to be aware of:

I. A matter of having an strategic plan

II. An internal perspective of the firm
III.The need of expanding the knowledge bases of SMEs
IV.How to access and secure resources: networks
V.The entrepreneurial aspects

I. A Matter of Having an Strategic Plan

While firms have an important degree of freedom to make their own decisions, the effect of the environment cannot be discounted. This matter becomes critically important in the context of emerging economies because firms are not only facing changes in the structure of the industry in which they operate, but also in the surrounding and institutional environments. To be aware of the different courses of action available, decision makers must understand all the pro-market reforms, not just those that most affect their own industry. According to Weick (1995), the strategic decisions that managers make depend on their cognitive structures and how they make sense of the environment. Managers need to understand any intended change in a way that makes sense or fits an interpretative schema or system of meaning (Bartunek 1984). Andrews (1980) compares the role of the owner-manager to an architect who is in charge of doing the synthesis. Senior managers have the role of analyzing, interpreting, and making sense of clues so as to formulate and implement strategies. Senior managers should act as catalysts to understand and create new interpretative frameworks that provide purpose and direction to the members of the organization (Westley 1990).

Laying a Formal Foundation: Making the Implicit Explicit

The fact that SMEs have inadequate organizational structures and managerial expertise is a real problem in a changing environment. SMEs do not have the same level of support to increase their competitiveness, and given the lack of managerial expertise, building an adequate structure is not a straightforward process, even though it is a central one. Formalizing routines and processes within firms to make them less dependent on a specific individual is key. This is an important concern because SMEs not only have a less highly developed structure, but their fate is closely linked to one or a few individuals who posses knowledge or resources that have not been made explicit to the rest of the firm.

Nevertheless, in a changing environment managers need to be proactive and to rethink their approaches regarding the future activities of their firms. A mere replication of previous strategies may no longer be a valid option when firms are competing in the international arena. The future can be imagined and enacted and that companies must be capable of fundamentally reconciling themselves by regenerating their core competencies and reinventing their industry. The role of managers is not to plan for the future, but to manage the process of learning and to be open to the possibility that new strategies can emerge.

II. Analyzing the Firm's Resources

An analytical examination of the resources of a firm may help to develop an understanding not only of possible short-run business strategies, but also of future diversifications (Montgomery and Wernerfelt, 1988), growth strategies (Penrose, 1959), and sustainability of long-term rents (Rumelt, 1984). SMEs can compete in the international arena, but they will face international competition from foreign SMEs as well as from multinational enterprises (MNEs). Focusing only on product-market strategies is not enough; instead, the long-term survival of a firm depends on the characteristics and endowment of its resources, which should be valuable and difficult to imitate (Mahoney and Pandian 1992; Grant 1991; Amit and Schoemaker 1993). To be able to compete, the manager-owners of SMEs must know the internal resources and capabilities of their companies. As Andrews (1980: 18-19) suggested, a firm should make its strategic plans “preferably in a way that focuses resources to convert distinctive competence into competitive advantage.”

Firms are a bundle of different kinds of resources and a set of commitments to certain technologies, human resources, processes, and know-how that manager-owners marshal. This issue is particularly important to the present study because it is not unusual that are controlled, managed, and run by one or a small group of individuals that have a deep, but tacit, knowledge of the firm. What is important is a clear identification—not just a vague idea—of the different resources on which a firm can depend.

How to Reconfigure a Firm’s Resources?

Capabilities exist when two or more resources are combined to achieve a goal and they “emphasizes the key role of strategic management in appropriately adapting, integrating and reconfiguring the internal and external organization skills, resources, and functional competences to match the requirements of changing environment” (Teece et al. 1997: 515). It is important to note that the relative endowment of firms may not necessarily relate to their financial performance because “only the service that the resource can render and not the resources themselves provide inputs into the production process” (Penrose 1972: 25). It is the deployment of a combination of those services that are critical to the rent generation of the firm. Firms need to exploit the existing firm-specific capabilities and also develop new ones (Penrose 1959; Teece 1982; Wernerfelt 1984) to compete internationally and to grow.

Over time, SMEs have seen the nature of their rents change; we should expect a shift from Ricardian to Schumpeterian rents. A company may not have better resources, but achieve rents because it makes better use of its resources (Penrose 1959). Rents depend not only on the structure of the resources, but also on the ability of firms to reconfigure and transform those resources. The above discussion leads to the formation of the following hypotheses:

III. The Need of Expanding the Knowledge Bases of SMEs

The capacity to exploit a new set of opportunities depends partly on the strategic decisions made by managers. In some cases, these opportunities require at least a reconfiguration of the activities of the firm, but more often, they require the incorporation of new resources and, especially, the introduction of new processes.

Firms are as systems of purposeful actions engaging in economic activities to achieve objectives, therefore, they must learn adapt and survive in a complex environment. Organizational learning is the process by which firms can cope with uncertainty and environmental complexity, and their efficiency depends on learning how the environment is changing and then adapting to those changes (March and Olsen, 1976).

SMEs need to enhance their learning in two different aspects.

1. First, internal knowledge should be coded and made available to selected members in the company. The manager-owner is knowledgeable about almost all aspects of the business (Mintzberg 1979), and his or her knowledge is personal in the sense that it is located in the mind and not always encoded or available to the rest of the firm. Routines should be created in order to secure the long-term existence of the firm because routines capture the experiential lessons and make that knowledge obtainable by the members of the organization that were not part of the history of the company (Levitt and March 1988).
2. The second way SMEs need to enhance their learning is to make changes in their knowledge base. When socio-economic environments change, firms need to assess the change in order to reformulate how they react to new incentives. The first step is developing a capability to understand the new dynamics. When regulatory and

> competitive conditions change rapidly, persistence in the same routines can be hazardous because managers and employees use organizational memory or knowledge to make decisions and to formulate the present strategy of the firm.

The effectiveness of decisions taken by an SME is greatly influenced by its knowledge base which, in turn, is the result of learning processes that are no longer applicable and may be misleading. Changes in the knowledge base are probably requisite for any firms competing in an industry with tradable products. Supporting infrastructure and routines may prove essential to increase the learning pace and to effectively integrate the new knowledge and reduce the inertia due to outdated knowledge.

IV. How to Access and Secure Resources: Networks

SMEs, compared to larger firms, face major challenges in terms of securing and updating resources. Where internal resources are important to accounting for a firm's performance (Gnyawali and Madhavan, 2001), resources also can be secured within networks that may allow firms to be competitive locally and internationally. Increasingly, networking is seen as a primarily means of rising required resources. Resources, such as information, equipment, and personnel, can be exchanged in networks because of relationships between. Networks are important instruments to ease the constraints facing SMEs in terms of access to: a) capital markets to obtain long-term finance both locally and internationally, b) narrow and highly regulated labor markets, c) information and technologies, d) inefficient tax codes, and e) highly bureaucratic and expansive legal procedures. SMEs may be part of a network not only because it may find complementary resources, but also because owners and managers may have friendship ties with other owners and mangers. These non-economic reasons may be as important as economic ones.

A Particular Kind of Network: Industry Clusters

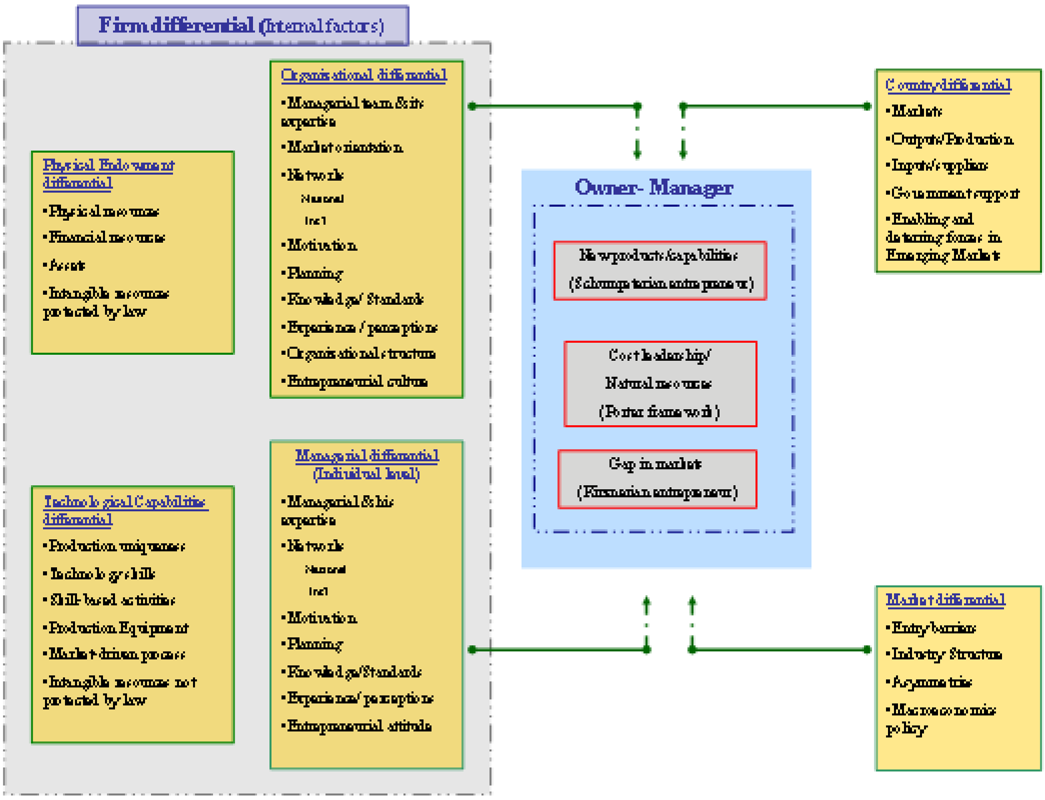
An extensive literature exists on the topic of industry clusters. Ricardo's "comparative advantages" can be considered as a pioneering concept of industrial clusters; and Marshall's exposition about externalities is based on industrial localization. Industrial clusters are characterized by having extensive interfirm exchanges and an advantageous environment to pursue business activities. Marshall (1961) argues that industry localization may be an important factor because a) it creates a market for workers with certain industry-specific skills, b) it promotes production and exchange of non-tradable specialized input, and c) firms may take advantage of informational spillovers. Krugman (1991) points out that given the existence of market imperfection, pecuniary externalities may also play an important role in determining the concentration of industry in a specific geographic location. Pouder and St. John (1996) argue that clustered firms have a greater legitimacy than firms outside a cluster. Clusters can provide a critical mass to counterbalance the political influence of large firms and to increase the pressure for investments that affect the productivity of the cluster. Furthermore, competition within clusters increases productivity and new firm development (Porter 1998).

V. The Entrepreneurial Aspects

Intangible internationalization requires facilitating learning by its employees in order to constantly transform the firm. Implementing mechanisms to expand the knowledge base and to diffuse information should allow SMEs to increase their capacity to develop new goods and services, and to compete in new markets. Key characteristics of this type of internationalization are common interests, trust and openness that allow employees to challenge assumptions. Intangible internationalization is a more difficult international expansion, but it provides sustainable competitive advantages. Consequently, SMEs would become competitive by reducing their costs, introducing new products and expanding their potential markets.

It is not possible to engage in tangible internationalization without having a minimum level of intangible internationalization or being competitive without some degree of valuable, rare, in-imitable, non-substitutable resources (Barney 1991). SMEs should aim for both types of internalization in order to take advantage of physical presence in foreign markets and constantly provide the incentives to facilitate learning, new organizational capabilities and processes.

Firms have different combinations of internationalization. In order to analyze how SMEs can take advantage of both tangible and intangible internationalization, the foundation of the potential competitive advantages need to be identified. Therefore, it is crucial to understand how firms deliver products that have value for customers, but also to understand what makes these firms different from the rest (Hall 1998). I argue that there are three major categories of differential that have a strong impact on the nature of internationalization of SMEs. The first is called *firm differential,* and includes a) organizational (team level), b) managerial (individual level), c) physical endowment and d) technological capabilities differentials. The second category is based on the home country characteristics and it is called *country differential*. The final category,*market differential*, takes into consideration the specific features of local markets and industries.



These differentials deeply influence the role of owner-manager. There are three basic approaches that a SME can adopt while anticipating and responding to the needs of its customers. The first one is the approach of the Schumpeterian entrepreneur (Schumpeter, 1934), a leader who breaks away from routine and introduces either new goods/services or new production processes for existing goods/services. The second one is related to Porter's (1980) concept of cost leadership even though Porter studied larger firms from developed countries. The last style of owner-manager is the Kirznerian entrepreneur, who is a person alert to opportunities (see figure 1). This type of role implies that the owner-manager acts as a broker in order to take advantage of over-optimistic or over-pessimistic reactions of economic agents (Kirzner 1973); therefore, the owner-manager will act "in regard to the changes occurring in the data of the markets" (Mises 1949: 255).

Conclusion

In the business literature, internationalization involvement usually results from one of two factors: a) the firm possesses some monopolistic advantage that it can use in another country, or b) the host country owns resources that are valuable to the foreign firm. While these reasons may be necessary and sufficient conditions for larger companies, is not necessarily the case for SMEs whom have no option but to internationalization.

1. Those two factors do not necessarily apply to SMEs because they need to become international even if they do not compete in international markets.
2. The average level of competitiveness of SMEs is below that of multinational enterprises.
3. SMEs are faced with international competition whether they decide to internationalize or to remain "local." Even SMEs providing non-tradable goods face a "demand side" pressure to meet the characteristic of similar product sell in other countries.
4. SMEs may not have the time required, according to this model, to meet world-class standards.

References

Amit, R. and Schoemaker, P. (1993). "Strategic assets and organizational rent". *Strategic Management Journal,*14(1):33-46.
Andrews, K. (1980). *The concept of corporate strategy. Homewood, Irwin.*
Barney, J. (1991). ¨Firm resources and sustained competitive advantage.¨ *Journal of Management,* 17(1): 99-120.
Bartunek, J. (1984). "Changing interpretative schemes and organizational restructuring: the example of a religion order." *Administrative Science Quarterly*, 29(3):355-372.
Child, J. (1972). "Organizational structure, environment and performance: the role of strategic choice". *Sociology,*6(1):1-22.
Gnyawali, D. and Madhavan, R. (2001). "Cooperative networks and competitive dynamics: A structural embeddedness perspective." Academy of Management Review, 26(3):431-445.
Grant, R. (1991). *Contemporary Strategic Analysis: Concepts, Techniques, Application.* Basil Blackwell, Cambridge, MA.
Itami, H. and Roehl, T. (1987). "Mobilizing Invisible Assets". Harvard Business School Press.
Kirzner, I. (1973). "Competition and entrepreneurship". *University of Chicago Press*,
Krugman, P. (1991). "Increasing Returns and Economic Geography." *The Journal of Political Economy*, 99(3):483-499.
Levitt, T. (1983). The globalization of markets. Harvard Business Review, 61(May-June): 92-102.
Levitt, B. and March, J. (1988)."Organizational Learning." *Annual Review of Sociology,* (14):319-340.
Mahoney, J. and Pandian, R. (1992). "The Resource-Based View Within the Conversation of Strategic Management." *Strategic Management Journal,* 13(5):363-380 .
March, J. and Olsen, J.(1976). *Ambiguity and choice in organizations.* Bergen: Universitetsforlaget.
Marshall, A., (1961 (1890)). *Principles of Economics.* London: Macmillan.
Mintzberg, H. (1979). *The structuring of organizations: a synthesis of the article*. Englewood Cliffs, N.J.: Prentice-Hall.
Mises, L. (1949). "Human action; a treatise on economics". *Yale University Press.*
Montgomery, C. and Wernerfelt, B. (1988). "Diversification, Ricardian Rents, and Tobin's q". *RAND Journal of Economics,* 19(4):623-632.
Penrose, E. (1959). *The theory of the Growth of the Firm.* John Wiley: New York.
Penrose, E. (1972). *The theory of the Growth of the Firm.* Originally published in 1959, Oxford: Basil Blackwell.
Porter, M. (1998). *On Competition.* Boston, MA: Harvard Business School Press.
Porter, M. (1990). *The competitive advantage of nations.* Free Press: New York.
Pouder, R. and St. John, C. (1996). "Hot Spots and Blind Spots: Geographical Clusters of Firms and Innovation."*The Academy of Management Review*, 21(4):1192-1225.
Rumelt, R. (1991). "How much does Industry Matter?" *Strategic Management Journal,* 12(3):167-185.
Schumpeter, J. (1934). *The Theory of Economic Development*. Harvard University Press.
Teece, D. Pisano, G. and Shuen, A. (1997). "Dynamic Capabilities and Strategic Management." *Strategic Management Journal,* 18(7):509-533.
Teece, D (1982). "Toward an economic theory of the multiproduct firm*". Journal of Economic Behavior and Organization,* 3:39-63.
Veloso, P. (1991). "International Competitiveness and the creation of an enabling environment." *International competitiveness, ed. By Irfan ul Haque, pp. 29-36. Washington, DC: Economic*

Development Institute of the World Bank.
Weick, K. (1995). *Sensemaking in organizations*. Newbury Park, CA: Sage.
Wernerfelt, B. (1984). ¨A resource based view of the firm.¨ *Strategic Management Journal,* 5(2):171-180.
Westley, F. 1990. "Middle Managers and Strategy: Microdynamics of Inclusion." *Strategic Management Journal,*11(5): 337-351.
Yasuf, S. (2001). "Globalization and the Challenge for Developing Countries." Policy ArticleWorking Paper 2618, the World Bank
Yip, G.. (2003). *Total Global Strategy II*. Prentice Hall, Upper Saddle River, New Jersey.

**Coordinador Académico de Finanzas*
FACS, Universidad ORT Uruguay