# NEW FINANCIAL DIMENSIONS OF THE SMES' INTERNATIONALIZATION

**Assoc. Prof. Laura Giurcă Vasilescu Ph.D**
**Assoc. Prof. Sorina Gârboveanu Ph.D**
**Lect. Daniel Goagără Ph.D**
**Faculty of Economics and Business Administration, Craiova, Romania**

**Abstract:** Globalization has brought a shift to the economic environment of the European SME. The progressively disappearing barriers and borders are exposing all companies both to new markets and to international competition. Consequently SMEs that do not consider internationalisation are self imposing a severe restriction on their potential for long term survival. Internationalisation is not to be considered as a separate part of the company or a strategy to be enacted only in times of reduced local demand, but fully integrated into the SME's long term activity, been proven as a key engines for competitiveness and growth.

**Key words: SMEs, internationalization, drivers, limits, financing, strategy**

## Introduction

Globalisation means the free movement of goods, services, capital, knowledge and leade to a more integrated global economy. Through globalisation national borders are constantly losing their significance as limitations for human interaction in general and for economic collaboration in particular. This means that for all economic actors their natural spheres of activity are expanding from national into multinational or even global. On a global scale the benefits of this greater economic integration and expanded trade relations have been praised and demonstrated so far.

But what is good in this macroeconomic scenario is also good for SMEs? And more importantly, how can European SMEs transform this into their advantage?

For an SME globalisation means that the natural or local environment is being constantly transformed and growing, which brings greater opportunities in the form of larger markets and new suppliers but also threats in the form of greater competition and shorter product life cycles. Yet many SMEs remain passive despite the fact that this shift to an increased complexity and faster pace of events can only be expected not just to remain but possibly accelerate in the future.

The greater integration and reduced barriers mean that international competition starts at home. Even businesses that focus primarily on the domestic market have to be competitive internationally in order to secure long-term growth.

This new, ever changing scenario that is globalisation will require and reward inventiveness, agility and flexibility: the very qualities that are commonly used to define SMEs. Embracing these qualities means that competitive SMEs will not only be in a position to tackle globalisation but embrace it and profit from it. Therefore, a pro-active attitude to global competition and markets is increasingly becoming not a choice but a matter of necessity. Each company must adopt internationalisation as part of the strategic search for the company's competitiveness and not as a reaction to a reduced national demand.

### Theoretical approaches regarding the SMEs' internationalisation

A number of theoretical approaches have been advocated as playing a key role in the internationalisation approach adopted by SMEs. They can be grouped in three categories (Lloyd-Reason et al, 2004): sequential, network and international orientation approaches.

1. *Sequential theory of internationalisation*

Adherents of this approach (sometimes called the "Uppsala model") include Johanson and Widersheim-Paul (1975) who examined the internationalisation of Swedish firms. They found a regular process of gradual change involving the firm moving sequentially through four discrete stages:

- intermittent exports;
- exports via agents;
- overseas sales via knowledge agreements with local firms, for example by licensing or franchising;
- foreign direct investment in the overseas market.

This particular sequence is sometimes called the *establishment chain;* the argument being that each of these stages marks a progressive increase in the resource commitment by the firm to the overseas markets involved. There is also a suggestion that as firms move through these sequential stages the knowledge and information base expands and the "psychic distance" between themselves and the overseas markets involved contracts making progression to the next stage that much easier. In this sense the model is dynamic, with the stage already reached by the firm in the internationalization process helping determine the future course of action likely to be taken. Put another way, the greater the resource commitment to the overseas market and the information and knowledge thereby acquired, the smaller the uncertainty and the perceived risks associated with further internationalisation, leading eventually to foreign direct investment and the establishment of a production affiliate overseas. Firms will move initially to countries which are culturally similar to their own (a close psychic distance) and only later move into culturally diverse geographical areas.

2. *Network theory*

In a network perspective the process of internationalisation is seen as building on existing relationships or creating new relationships in international markets, with the focus shifting from the organisational or economic to that of the social (Chetty and Holm 2000). It is people who make the decisions and take the actions. The series of networks can be considered at three levels:

• *Macro* - rather than the environment being seen as a set of political, social and economic factors, network theory would see it as a set of diverse interests, powers and characteristics which may well impinge on national and international business decisions. To enter new markets a firm may have to break old relationships or add new ones. A new entrant may find if difficult to break into a market which already has many stable relationships. Those firms better able to reconfigure their existing networks or which are seeking to enter overseas markets with few existing networked relationships, may be more successful in the internationalisation process.

• *Inter-organisational* - firms may well stand in different relationships to one another indifferent markets. They may be competitors in one market, collaborators in another and suppliers and customers to each other in a third. If one firm internationalises, this may draw other firms into the international arena.

• *Intra-organisational* - relationships within the organisation may well influence the decision making process. If a multinational enterprise (MNE) has subsidiaries in other countries, decisions may well be taken at the subsidiary level which increases the degree of international involvement of both the parent MNE and SMEs in the supporting value chain, depending on the degree of decentralisation of decision making permitted by the firm. Outsourcing opportunities within an increasingly globalised economic environment may play a part here.

The network approach would suggest that internationalisation can be explained, at least in part, by the fact that other firms and people who are involved in a national network themselves internationalise.

3. *International orientation of decision makers*

An extensive literature identifies the international orientation of the owner-manager or other key decision makers in SMEs as a key determinant of the nature and extent of internationalization (Weidersheim-Paul 1972, Reid 1981, Cavusgil and Godiwalla 1982, Harrison 1992, Mugler 1996, Morgan 1997, Lloyd-Reason and Mughan 2002). In terms of the "internationalisation web", the willingness and ability of the strategic leader (CEO/owner manager) is seen as dependent on the exposure to a range of factors including existing formal and informal international contacts, knowledge of foreign competitors, cultures, language skills, educational background.

The effective use of scarce governmental resources directed towards the encouragement of SMEs to begin, for the first time, to internationalise their operations might usefully take account of such indicators (Harrison 1992). For example, the first phase of policy support mechanisms might focus on further developing the international orientation of strategic leaders/key decision makers in SMEs as a precursor to subsequent, more functionally directed phases of support. More and more, the policy focus shifts from issues of international orientation and is now directed towards equipping SMEs in terms of their skills and resource base.

## Drivers to internationalization

The attitudes that lead to internationalisation stem from the same source as start-ups, innovation and entrepreneurship: developing lines of growth. In the case of SMEs the reasons that move companies to internationalise are closely related to the personal and professional experiences of the owner/manager and the evolution of the SME.

Extensive literature supports that international orientation of decision makers is a determinant of the nature and extent of internationalisation. Thus, one of the key predictors of performance is the international commitment of the founders, entrepreneurial firm behaviour and pro-activity in foreign markets. Also, the firm age and the CEO age are the main predictors for becoming an internationally committed company.

This international orientation is a consequence of the professional experience of the owner/manager and the industry/sector to which the SME belong. In these cases the level of international exposure plays a key role. The central role of the entrepreneur and his personal networks is even more important in the case of "born globals".

Therefore, the exposure to internationalisation, either because the sector is particularly exposed or because of the personal and professional experience of the owner/manager, are the main drivers to internationalisation.

Dynamic entrepreneurs are particularly well placed to reap opportunities from globalization and from the acceleration of technological change. This somehow makes internationalisation a "closed loop" where previous experience is the best guarantee to the future one: internationalisation breeds internationalisation.

This already indicates what should be the first and earliest intervention in order to foster internationalisation. An international orientation by the SME decision makers is necessary and the first phase of policy support mechanisms might focus on developing the international orientation and formal entrepreneurial training of key decision makers in SMEs.

Raising more international SMEs will require raising more international entrepreneurs. This calls for early interventions preferably in the educational system, to actively promote greater exposure to the international environment and demonstrate the benefits of an international orientation.

On the short term this calls for policies on continuous education for SMEs, particularly in the area of language acquisition. But more important, the Government policies could consider the relevance of this driver in order to boost the pool of future international entrepreneurs by promoting greater awareness and exposure to foreign cultures, supporting early language acquisition and fostering the acquisition of entrepreneurial attitudes and internationalisation.

The other drivers to internationalisation are the followings:

- access to know-how and technology;
- increased efficiency and economies of scale;
- increased competence by entering difficult markets;
- exploiting the advantage of leading edge technology which are closely related to innovation.

In this context, the Small Business Act adopted recently by the European Commission, settled up a set of ten principles to guide the conception and implementation of SME'policies both at EU and Member State level. The first of this principles stipulates that the EU and Member States should create an environment within the entrepreneurs and family businesses can thrive and entrepreneurship is rewarded. Therefore, the Commission is promoting entrepreneurial culture and facilitating exchanges of best practice in enterprise education. Another principle regards the commitment of the EU and Member States which should support and encourage SMEs to benefit from the growth of markets outside the EU, in particular through market-specific support and business training activities.

### Main barriers to the internationalisation of SMEs

Successful policies to increase the number of internationalised SMEs must start by understanding which are the main problems faced by SMEs when considering the possibility to start operating with a foreign partner. According to the OECD the main barriers to greater internationalisation as reported from SMEs are:

1. Shortage of working capital to finance exports;
2. Identifying foreign business opportunities;
3. Limited information to locate/analyse markets;
4. Inability to contact potential overseas customers;

5. Obtaining reliable foreign representation;
6. Lack of managerial time to deal with internationalisation;
7. Inadequate quantity of and/or untrained personnel for internationalization.

These problems could be grouped in the three SME's main areas of concern:

- insufficient managerial time and/or skills required for internationalization;
- lack of financial resources;
- lack of knowledge of foreign markets.

A successful and sustainable internationalisation will require an internationalization strategy and the acquisition of a series of capacities, abilities and resources prior internationalisation. This is the explanation for the proven relation between competitiveness and internationalisation. The relationship between internationalisation and productivity at firm level is valid both for exports and for imports. The latter is consistent with knowledge and technology acquisition through imports of intermediates and capital goods.

Empirical research has associated successful small firms with greater skills in organizational learning and strategy development (Julien and Ramangalahy, 2003). Numerous studies have shown that companies with a structured market strategy are more active exporters than firms lacking formal planning (Sadler-Smith et al, 2003). There was identified a positive relationship between organizational capabilities and small business performance.

Comparing exporting and non-exporting firms it was discovered that companies with formal market planning were more likely to be active exporters, while firms lacking formal market planning failed to enter foreign markets. The more systematic the selection of foreign target markets the higher the export performance will be for SMEs. This underlines the importance of support in the area of managerial competences for those SMEs considering internationalisation. It also starts to hint one of the main SME problems in terms of internationalisation readiness: the severe SME lack of international strategy.

This situation is closely related to size: on average, the smaller the SME the more management building capabilities required. Small SMEs tend to have lesser structured management procedures and a tendency to making opportunistic rather than systematic strategic decisions.

There is certainly concern that SMEs have usually resorted to using support services in a rather haphazard and ad hoc manner, reflecting the particular needs perceived at any given point in time by the key decision makers themselves rather than using such support services as part of a strategic approach to internationalisation.

A structured management system is fundamental for a successful internationalisation and may be one of the key elements that hinder further SME internationalisation. This already point out to one of the main areas of support.

The lack of financial resources to tackle internationalisation is another key impediment for many SMEs and has been consistently reported in surveys as one of the main areas where support is required. Policies or programmes that fail to incorporate the financial dimension of internationalisation will not be providing support that not only is demanded but required from SMEs willing to internationalise.

Accordingly with the sixth principle of the Small Business Act, the EU and Member States should facilitate SMEs' access to finance, in particular to risk capital, micro-credit, mezzanine finance and develop a legal and business environment supportive to timely payment in commercial transactions. Therefore, the Commission evaluates the options for introducing a private placement regime destined to facilitate cross-border investment in order to strengthen European venture capital markets and it will offer assistance to Member States to develop high quality investment programs.

### Level of internationalization for European SMEs

SMEs represent 99% of SME across Europe and similar figures around the world. Yet their level of internationalisation and weight in world trade is substantially below that number. According to the Observatory of European SMEs:

- only 8% of total EU27 SMEs are involved in exports,
- only 12% of the inputs of an average SME are purchased abroad,
- 5% of SMEs in the EU receive some income from foreign business partnerships, either from subsidiaries or joint ventures abroad.

This picture broadly coincides with the evidence gathered from Member States. In Romania, SMEs represent 99.6% of total companies but only 90% of exporters and a very modest 27.5% of total exports. Not all SMEs present the same internationalisation profile. The latest data confirm that internationalisation is related to company size. As an example, the table 1 shows the import intensity of EU companies by size.

**Table 1. Inputs purchased abroad – EU27 (%)**

| Size class | Inputs purchased abroad (%) |
|---|---|
| 1-9 persons employed | 11.5 |
| 10-49 persons employed | 13.3 |
| 50-249 persons employed | 15.8 |
| 250+ persons employed | 17.6 |
| *EU27 SMEs* | *11.7* |

*Source: European Commission, Final Report of the Expert Group on Supporting the internationalisation of SMEs, Dec. 2007*

This tendency is also reflected when plotting other internationalisation aspects like exports or external foreign direct investment: the larger the size of the SME, the more internationalised. This relation between size and internationalisation is universal across all EU 27 countries and is one of the most relevant.

Another important aspect is the analysis of internationalisation by trade partner countries. For any European country the internal market remains the key partner any internationalisation activity. In terms of trade the EU represents 2/3 of total trade for the average Member State.

The importance of the internal market as the key partner is even more accentuated in the case of SMEs. The figure 1 shows the relative importance of the internal market for European SMEs. The evolution reflects that SMEs tend to interact more with countries across the border rather than distant ones. The predominance of the EU as the key market remains universal and constant across all SME sizes (table 2).

**Table 2. Main destination of exports for SMEs – by size (% of exporters)**

| Size class | EU country | Europe, outside EU | Outside Europe |
|---|---|---|---|
| 1-9 persons employed | 73 | 14 | 13 |
| 10-49 persons employed | 71 | 9 | 20 |
| 50-249 persons employed | 73 | 11 | 16 |
| *EU27 SMEs* | *72* | *13* | *15* |

*Source: European Commission, Final Report of the Expert Group on Supporting the internationalisation of SMEs, Dec. 2007*

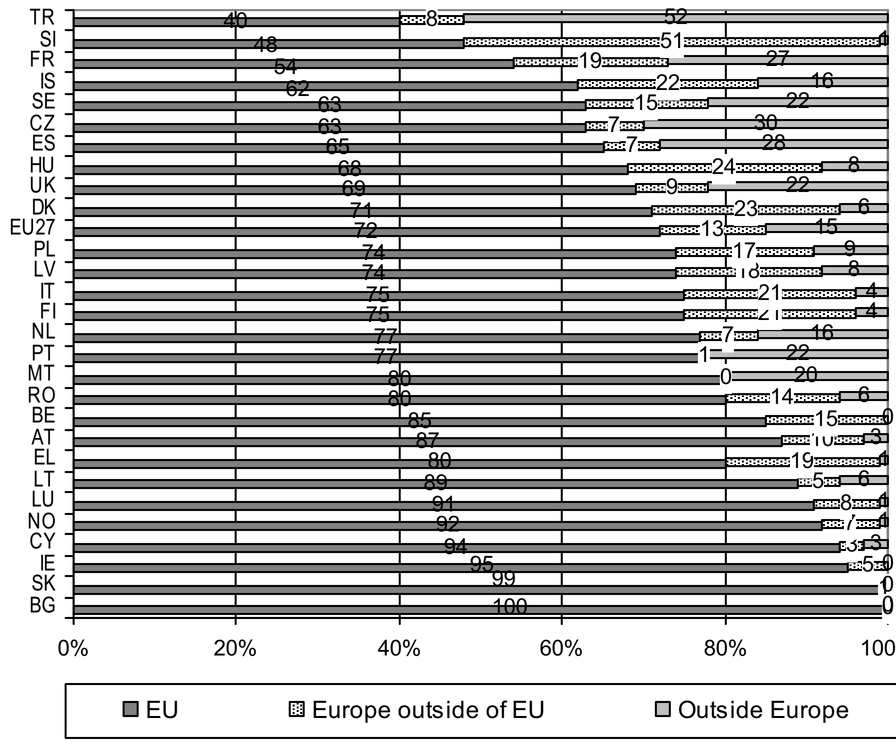


**Figure 1. Main destination of exports for SMEs – by countries**

Considering only trade flows the importance of the EU as the key partner for SMEs is also reflected across all sectors of activity (table 3).

**Table 3 Main destination of exports for SMEs, EU27 – by sectors (%)**

| Prime destination of exports (% of exporters, EU27) | EU country | Europe, outside EU | Outside Europe |
|---|---|---|---|
| Manufacturing | 73 | 12 | 15 |
| Construction | 72 | 17 | 10 |
| Wholesale and retail | 66 | 14 | 20 |
| Hotels and restaurants | 97 | 0 | 2 |
| Transport, storage and communication | 83 | 9 | 7 |
| Financial intermediation | 85 | 11 | 3 |
| Real estate, renting and business activities | 77 | 13 | 10 |
| Health and social work | 92 | 8 | 0 |
| Other community, social and personal service | 83 | 16 | 0 |

*Source: European Commission, Final Report of the Expert Group on Supporting the internationalisation of SMEs, Dec. 2007*

The data indicate that the services are even more dependent (in terms of trade) on the EU market than products.Also, the analysis indicates a particularly relevant increase in intra-industry trade which has grown faster than total trade, particularly inside the EU.

Trade in intermediates is growing and domestic production increasingly relies on foreign inputs. This seems to indicate very clearly that further integration both at a global level and most particularly at an European level (full consolidation of the internal market) have been gaining momentum in the last number of years.

The evolutions on FDI and capital flows underline the previous statement and indicate strongly that even for SMEs internationalisation is growing beyond just foreign trade. Accordingly with Eurostat (European Foreign Direct Investment Yearbook, 2007) the Intra-EU FDI flows (inflows+outflows) account for 80% of total EU FDI flows in 2004-2005. North America represents half of the remaining 20% both for inflows and outflows.

Again, for European SMEs the destinations of foreign business partnerships are more likely to remain in Europe: 77% of the locations of all joint ventures and foreign subsidiaries mentioned are in the territory of the EU.

### Measures to promote greater SME internationalization

Internationalisation of SMEs in the form of export promotion has been a prominent element in European Government policies for a long time and nowadays all European Governments devote a considerable amount of resources to the issue.

Programmes to support SME internationalisation have traditionally been focused on promoting greater exports and usually developed independently from other policies. In fact, approximately 70% of all of them are focused exclusively on supporting exports. Yet the most potent argument in favour of governmental support lies on the fact that SMEs play a key role in the stability and potential of any national economy. As most SMEs face resource limitations, they need to be supported to acquire the capabilities needed to compete successfully in the international market.

In this context, one of the central concerns of Governments and support organisations must be the low numbers of SMEs involved in internationalisation which may be curtailing their future growth and competitiveness. In order to maximise the effectiveness of government funds for supporting internationalisation of SMEs policies should consider:

a) *A successful policy for internationalisation must consider the barriers that impede or restrain the internationalisation of SMEs and the drivers that move companies to internationalise*. The former is essential to produce results in the short and medium term. The second creates the basis for a long term policy on internationalisation.

b) *For increased effectiveness each country will have to build its own set of policies based on experience* and focused around the actual SMEs they are trying to support. Increased and regular co-ordination between the Central Government, the support agencies and sectoral, local and regional actors should be improved as the best way to guarantee best use of available resources. A fluid, integrative and consultative process between all the stakeholders (Government, support agencies and SMEs) is possibly the best key for successful policy development. In the case of Romania, the business community was involved both in the creation (in 2004) and currently the management of the National Export Council, the body charged with developing national export policy.

c) In the dilemma between concentrating support on a short number of winners (usually companies that have already started their internationalisation process) or providing support to the larger number of non or minimally internationalised companies *the greater effort must be placed in increasing the number of internationalized SMEs.* Evidence from studies (De Clercq et al, 2005) supports this second approach as the most efficient in the long term. This also supports the fact that there is a performance advantage in rapid internationalisation. That is, the earlier a company internationalises the faster it seems to grow.

d) *Internationalisation is a moving target.* The level of internationalisation of the SME is related to its size and resources. The problems and the corresponding support measures required will have to change as the company evolves and grows.

e) *Micro and Small companies present a vast internationalisation potential.* Thus in recent years an impressive increase has been reported in the 1 person firm and 2-9 person firms category.

f) One of the main reasons for non utilisation of support is *that enterprises lack awareness.* In general smallest SMEs do not have the desirable knowledge about the support measures due to the lack of resources devoted to internationalisation. *This calls for a simplified information and access points.* Yet the common situation is of numerous and often un co-ordinated support institutions providing what some SMEs describe as a "Promotion Jungle". In terms of actual support in Germany only 34% of micro SMEs (up to 10 employees) participate in promotion programmes in contrast to 54% for medium sized companies (50 to 250 employees) and 70% for companies of over 500 employees.

g) *Stimulating higher value-added activities*. There is a progressive shift from low and medium-technology manufacturing exports towards high technology manufactures.

h) Effective support to SMEs must consider the variables that influence the process of internationalisation: available financial and human resources, company size and stage of internationalisation, sector, geographical location, target markets, etc. All this strongly supports *an approach based on individualised support to each SME* and the implicit recognition that internationalisation goes well beyond the international department of the company.

In general, there is a strong relation between all competitiveness policies. Just as with internationalisation, the main support to promote more innovation intensive start-ups should focus on the promotion of management skills, supporting the creation of trans-national networks, bridging the financial gap and the need for government support.

In the case of high tech firms usually characterised by intense competition and shorter windows of opportunity, early internationalisation is fundamental to increase their economic success. In addition to sharing common drivers, SME innovation and internationalisation are inversely related to the size of the company and share the same main barriers: lack of financial resources and lack of management skills. Another area of potential synergies between innovation and internationalisation is in the management of support programmes to "born globals". These are companies usually associated with a new technological development, that internationalise extensively shortly after inception and in a very short period of time.

Building on this and on the proven relationship between technology, knowledge, productivity and exports a trend is starting to appear fundamentally in the most advanced countries towards integrating policies for competitiveness and growth.

Internationalisation is starting to be merged with the other (particularly innovation) policies and they are stating to be seen as part of the same issue: policies to enhance sustainable long term competitiveness. As sectors and progressively countries move up the value chain the rationale for the integration of internationalisation and innovation into a single set of competitiveness policies becomes more evident.

But it is critically important to remember that innovation is a lot more than research. It comprises technological innovation and innovation in operations and management. In relation to SME competitiveness, for the vast majority of companies there is a large potential for innovation in operations and management, including the acquisition of IT and quality systems and capabilities. The eighth principle of the Small Business Act regards the promotion of upgrading of skills in SMEs and all forms of innovation

As part of SME innovation, standardisation plays a key role in fostering the competitiveness and growth of SMEs and has been identified as one important element for SME greater involvement in global value chains. Accordingly with the ninth principle of the SBA, The EU and Member States should encourage SMEs to benefit more from the opportunities offered by the Single Market, in particular through improving the governance of and information on Single Market policy, enabling SMEs' interests to be better represented in the development of standards and facilitating SMEs' access to patents and trade marks.

## Conclusions

It is difficult to separate internationalisation from the context in which it is a natural element: competitiveness and growth. This calls for a more integrative "holistic" approach in all the areas related to supporting the internationalisation of SMEs: in the development of policies, programmes and in the delivery of support. It will also require policies to upgrade the human resource base of the economy. Addressing this through education and training policies will require a growing focus on life-long learning.

Policies to support internationalisation should start by considering the drivers and the barriers for SME internationalisation.

A long term policy outlook should consider policies based on the main driver to internationalisation: positive attitudes toward entrepreneurship and international activities, which calls for interventions in the educational system.

More immediate support should be based on supporting SMEs in the areas of reported need: lack of managerial resources and skills for internationalisation, lack of sufficient financial resources and availability of usable information.

Government support for the internationalisation of SMEs remains vital. SMEs are likely to benefit disproportionately from the pro-competitive effects of internationalization and government support produce a high level of "additionality": an important number of SMEs would not have internationalised without the Government support.

Taking into consideration that countries are not competitive but the companies are, internationalisation can not be separated from a company's competitive position. And each company will have its own set of individual variables and barriers for competitiveness. Consequently, the most effective way to guarantee a successful long term internationalisation is to provide individualised support for each company, beyond supporting the merely "international" part of the company.

Successful support will have to be based on building capabilities inside the SME where access to training and consulting should play a central role. This will require scoring, filtering and analysing companies prior to providing any support and adapting the mix of standardised support programmes to create a company specific support plan.

All key stakeholders must be involved in the development of policies and programmes: regional and national bodies, internationalisation agencies, business representatives and banks. This is conducive to developing support that is required by the SMEs, avoid overlapping of programmes and maximise allocation of resources. Development of policies is probably better co-ordinated at national level. But for maximum results implementation must be at local or regional level.

In order to enhance competitiveness and growth, programmes must support internationalisation, not only exports. The main internationalisation programmes must permit the participation of the widest number of SMEs possible. Also, programmes must be demand driven and adaptable. They must incorporate feedback from SMEs in order to evolve as SME needs shift. A strong emphasis must be placed in supporting and promoting networks at all possible levels.

Internal size is conducive to greater competitiveness in the international arena. In this respect the potential of the internal market is far from fully exploited as the internal market could act as a breeding ground for international companies that may become global players. Support of direct SME co-operation, matchmaking, promotion of intra-European value chains could be conducive for greater competitiveness and growth An important effort must be placed in raising SME awareness of the need to internationalise. Ideally this should be coupled with an easy access to support based on the one stop shop principle.

Internationalisation agencies have to become customer led and customer centred and offer comprehensive support. This also opens the door for service integration which is conducive to additional synergies.

It is recogniyed that the key challenge for the EU today consist on managing the transition towards a knowledge-based economy. Success will ensure a competitive and dynamic economy with more and better jobs and a higher level of social cohesion.

Dynamic entrepreneurs are particularly well placed to reap opportunities from globalization and from the acceleration of technological change. The capacity to build on the growth and innovation potential of SMEs will therefore be decisive for the future prosperity of the EU. In a globally changing landscape characterised by continuous structural changes and enhanced competitive pressures, the role of SMEs in our society has become even more important as providers of employment opportunities and key players for the wellbeing at the local, regional and global level.

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