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Challenges of Internationalization for SMEs and Overcoming these Challenges: A case study from Turkey

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Abstract

Internationalization of SMEs has been a topic researched in a multitude of views. Differing scholars have tackled the subject from different points of view and found out that there is not one single path to internationalization. This study aims to build on the previous literature by applying ethnographic study on an SME in Turkey that has been an active importer from Germany since its inception. The aim has been to find the connections and the applications of different theorems for a small firm. Through this study the challenges a SME faces during the process of internationalization is also highlighted. Through observations and personal interviews conducted, it is found that uncertainties, conflicts in a network, profitable domestic market and lack of experienced management involvement hold a major part in decreasing international activities.

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Keywords: Internationalization; SME; Uppsala model; Born Global model; innovation-related model; network model; resource based view; import; export; growth; challenge

1. Introduction

The purpose of this study is to have an in-depth research on the behavior of SMEs against the challenges they face in their internationalization process. In order to accomplish this task, several research questions will be sought which explain the process of internationalization in SMEs step by step and highlight the challenges they face, and their reactive and proactive responses to these challenges.

It is desired to understand the process these firms went through beginning from their decision of being international to their planning process, their initial actions during their first stages of internationalization, their reasoning behind these actions, their mobilization of internal resources in order to succeed with these initial entries into international markets, their usage of internal firm strengths and utilizing the external opportunities, minimizing their internal weaknesses, maneuvering against external threats in order to minimize their effects. It is also desired to understand the progress after the internationalization activities begin, such as understanding which form of entry method (exporting / licensing / joint venture / direct investment) the firm uses in their entry into foreign markets and the reasoning behind

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choosing that method, the sort of internal and external challenges the firm has faced during its international activities, how did the firm position itself in order to overcome these challenges.

This study will also give an in-depth view on the activities and actions of Turkish SMEs for internationalization and could present a framework for firms, helping them with their own internationalization activities. This is also useful since the literatures on SMEs are focused on developed countries, as such the work on developing countries is lacking. As such, the purpose of this study is to work on all of the aspects of internationalization for small firms.

2. Literature Review

Internationalization is an ambiguous term that is described slightly differently in multiple studies. Calof and Beamish (1995, p. 116) have defined internationalization as “the process of adapting firms’ operations (strategy, structure, resources, etc.) to international environments”. Chetty and Campbell-Hutt (2003) used the definition of Calof and Beamish (1995) in their paper, stating that this definition of internationalization also contains the occurrences of de-internationalization, which are actions that reduce the internationalization exposure of a firm. Johanson and Vahlne (2009) have reiterated that internationalization can lead to lesser exposure in the foreign markets. This contrasts Welch and Lusterinen (1988)’s definition of increasing involvement, as internationalization also covers decreasing involvement of firms in the international markets.

Internationalization, as explained by the authors Schweizer et al. (2010) is a process where a firm strives to get a better position within a multitude of networks, which are mostly abroad in foreign markets. They also state that internationalization is an entrepreneurial activity and they propose entrepreneurship aspect be added to the revised model of business network internationalization process of Johanson and Vahlne (2009) which in turn is a revised model of the previous Uppsala model of Johanson and Vahlne (1977).

Johnson and Vahlne (2009) revised their earlier 70’s work on internationalization, in which they proposed that internationalization should be seen as the end product of firms that are seeking and utilizing multiple opportunities in order to overcome foreignness. The authors propose that firms can either use their current networks, with which they already have connections with, to enter a new market; or they could be contacted with a firm working in a foreign market and through continuing business practices, trust emerges and a new network is established.

Prior research on the internationalization of firms is summarized below:

Table 1. Internationalization literature of firms (Xu H., Sarah N. 2009)

Direction	Key words	Internationalization theories	Underlying theories	Explanatory variables
Why literature	Firm foreign market entry models	- Hymer’s framework - Internationalization theory - Eclectic framework	- Industrial organization - Transaction costs	Transaction characteristic, stemming from firm specific resources such as knowledge
		Organizational capabilities	- Resource based view - Dynamic capabilities	Firm know-how
How literature	Internationalization process	Uppsala model	- Penrose’ theory - Behavioral theory	Market knowledge gained through experience in international market

		Network theory	- Social exchange theory - Resource dependency theory - Behavioral theory	Social and cognitive established among network members
What literature	The phenomenon of international new ventures	International new venture perspective	- Entrepreneurship perspective - Resource based view	Entrepreneur's knowledge Technological know-how Learning advantages of newness

For the specific models that explain how firms internationalize, two major disciplines present themselves. These two models are the gradual internationalization of firms and rapid internationalization of firms (Johanson and Vahlne, 1977, Oviatt and McDougall, 1994, Knight and Cavusgil, 2004, Johanson and Vahlne, 2009 and Schweizer et al., 2010). These models differ in their approach to the internationalizing firm, and its internationalization practices. The firm size, their preferred entry methods into foreign new markets, and the strategies undertaken through the internationalization processes differ for these models (Wai and Noichangkid, 2012). Most widely, the Uppsala models represent the gradual internationalization of firms whereas the Born Global model represents the rapid internationalization of firms. According to Pederson (2000), the initial Uppsala model was devised as a criticism of previous studies that did not take cultural differences between home and target markets, lack of knowledge on the desires and processes, valid legal issues, and other market specific information of the target markets, and the internal capabilities a firm needs in order to handle its business profitably in the international markets, such as human resources, organizational and financial resources.

There are two Uppsala models for internationalization of SMEs. The first one is a resource based view by Johanson and Vahlne (1977), which is an internal view of the capabilities and incremental steps of a firm while internationalizing and the revised model by Johanson and Vahlne (2009) that is a network view, which is an external view that focuses more on the external environment of a firm that is internationalizing. Pedersen (2000) states that, the initial model has lacking points which were ignoring the external factors, such as competitiveness within the market, and relevant economic data on the market such as the potential of the market for growth and profitable business. In both Uppsala models, the internationalization process is a gradual step by step process where the firms seek risk management. In the initial model, the lack of foreign market knowledge was seen as a major deterrent against rapid internationalization of firms, whereas in the later model brought in the importance of networking amongst the firms for internationalization (Figueira-de-Lemos et al., 2011 and Wai and Noichangkid, 2012). As such, it was proposed that firms gradually internationalize in order to acquire the necessary foreign market knowledge and general knowledge on the structuring of an internationalized business. The reasoning behind was that firms gained the required knowledge over time while they were taking gradual, small steps on internationalizing completely. (Johanson and Vahlne, 1977 and Wai and Noichangkid, 2012)

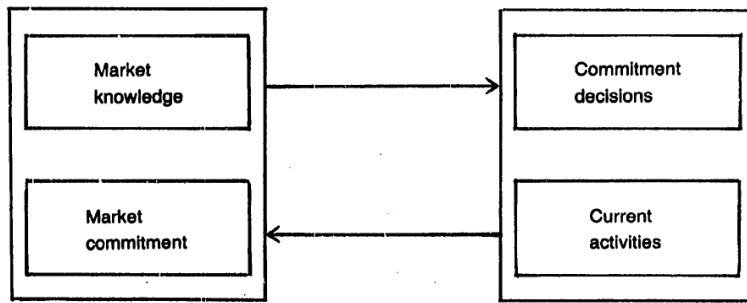


Figure 1. The Basic Aspects of Internationalization – State and Change Aspects (Johanson and Vahlne 1977)

Johanson and Vahlne (2009) states that, a new model, business network internationalization model, was proposed that linked different variables such as knowledge capabilities of the firm, network position of the firm, and the business opportunities it perceives; and that these variables were found to play a huge role behind SMEs in their internationalization processes. The authors explain the terms “liability of outsidership” and “liability of foreignness” as the main challenges firms face during internationalization. Liability of outsidership is explained to be the lack of knowledge on the business environment and its players in the targeted market and liability of foreignness is the psychic distance, the sum of all the factors such as different laws, language barriers that create a problem for a firm to be an insider and get well known in the target market.

Innovation-related model is another model in explaining the internationalization of SMEs. This model suggests that there are six different stages of internationalization and every stage is an innovation for the firm. These stages are determined on export/total sales ratios.

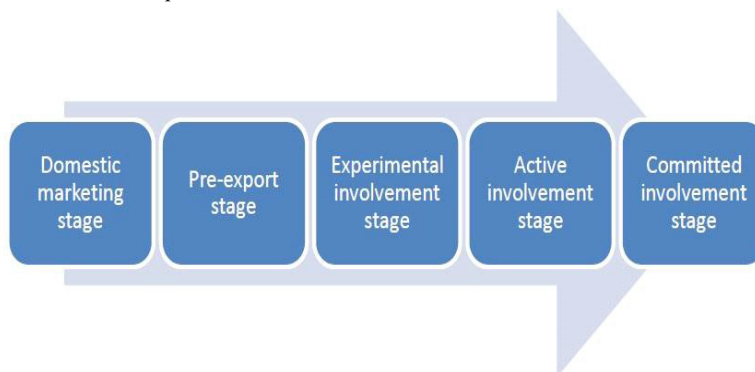


Figure 2. Stages of innovation related model (Otto Andersen, 1992 page 213 as edited by Tahir and Mehmood, 2010.)

According to Gankema et al. (2000), innovation related model is based on export development of firms. Andersson (2000) adds that this model considers the learning process of the firms and the managers as a vital factor in the success of internationalization of the firms. It has also been found by Clercq et al. (2005) efforts of international knowledge gathering and putting importance on entrepreneurial orientation is beneficial for internationalization, while giving importance to domestic knowledge gathering is detrimental to internationalization.

Hermel and Khayat (2011) propose that the Born Global model concerns itself with the firms that are active within the international markets right from their founding. The born global firms have a clear distinction compared to their more traditional brethren. Wai and Noichangkid (2012) points out that these born global firms tend to have small domestic market shares compared to their foreign market shares, whereas according to the Uppsala models the traditional firms have strong domestic market shares before the internationalization process.

Reasoning behind the entry to international markets could either be proactive or reactive. Proactive entry conditions are; attractive expanding international markets, economies of scale and increase in profits. Reactive entry conditions are; domestic market saturation, increasing product or supply costs and low profitability in the domestic market. (Lesáková, 2005) Han and Noller (2009) note the proactive entry conditions to be the aggressive reasons and the reactive entry conditions to be the defensive reasons to go international. The authors also note that in most internationalizing firms; both proactive and reactive entry conditions can be found.

There have been studies that focused on the challenges of SMEs from a specific market point of view. One such study is Albertini, Auffrey and Aziz (2011), where they studied the challenges of Swedish firms that enter the Russian market. This study was focused solely on the Russian market and hence the market specific challenges select Swedish firms have faced, and their actions in order to mitigate the problems they have faced in the Russian market. The main challenge Swedish firms were reporting in that study was the import tariffs imposed by Russian government and the administrative tasks associated with importing into Russia. The study of the Gallup Organization (2007) for the European Commission has also showed that import tariffs and custom duties come as the second biggest constraint alongside lack of capital behind the lack of foreign market knowledge for European SMEs.

3. Research Setting

The proposed sample is X Company, a distributor of German window and sliding door fittings in the Turkey. X Company is a distributor of Y Company and Z Company in the accessories business. X Company was found in 1990. It began its business life as an importer and local distributor of specialized German windows fittings. The owners have attended local fairs in order to build and contain networks and market new products to the market. Currently X Company has 6 million annual turnover and 30 employees including the management and the owners. While the company's headquarters is located at İstanbul, it has active warehouse and distribution centers at Bursa and Ankara. X Company is an Export Stage 5 (Experienced Exporter) according to Bilkey and Tesar (1977) as at least 10% of the company's turnover comes through exporting each year. Recently, X Company has started manufacturing highly specialized products and also distributing the input materials of those products to several dealers. Therefore, X Company is planning to apply for contractual projects, both in the domestic market and in the foreign markets.

X Company, contrary to most of its current competitors, was found with the distinct intention of distributing high quality hardware that has been imported. As such, X Company was active in the international market from its inception. Also X Company was importing new hardware that has not been used in Turkey before; as such it took active role in shaping the domestic market. Due to its nature being a vast and experienced distributor of several select brands of hardware, X Company has desired and attempted to successfully tackle the international markets, albeit with only marginal successes.

Studying X Company could potentially point out the setbacks SMEs face during their internationalization processes that can hamper their international growth. This could illuminate the challenges of internationalization, seen through

the lenses of a company that was active on international markets since its inception and was experienced in shaping and leading markets into accepting new standards.

4. Methodology

Yin (2009, p.8) states that amongst the different research strategies, the researcher makes the choice of selecting the desired method by following several guidelines. For the choice of the method the author notes the form of the research, the amount of control over current behavioral events, and the level of focus on contemporary events as opposed to historical ones as the important variables in determining the correct method.

For this research, an ethnographic study was conducted. An ethnographic research dedicates itself to creating a picture in which how people progress their daily lives and form meaning out of their own interactions and surroundings can be seen (Erdem et al., 2011).

For this study, ethnographic research was chosen because as Erdem et al. (2011) notes its nature of allowing the researchers to obtain a deeper insight of the processes. They argue that ethnographic studies do not limit the researcher to a one dimensional cause and effect analysis, but allow them to grasp the bigger picture within a social network. The reasoning behind their argument is that ethnographic researches do not create an unnatural construct to test the relevant theories, but seeks to conduct the data information in a natural environment. In conjunction, Fetterman (1998) has stated that ethnography is a research method used mostly by social sciences that aims to shine light onto the distinctive features of a culture or of a group.

In this study, ethnographic data from 15 months is used to show the challenges the sample firm faces during its internationalization process. Primary and secondary data is used for research purposes. Primary data is obtained through semi-structured interviews and observations. Secondary data is obtained from questions directed at the firm officials on firm details and on market research. Semi structured interviews are interviews with a set of questions with the interviewer having the authority to change the wording of each question and ask new different questions (Siawsurat and Önel, 2011).

During the study deductive approaches are sought. Siawsurat and Önel (2011) note that the deductive research approach aims to prove existing theories from empirical data while the inductive research approach aims to reach and form a theory from the data.

The data obtained is used to analyze the firm in terms of the similarity of their actions compared to prior literature. Quotes are used from the interviews to show the connection between the data that is being analyzed and the interpretation of the data.

5. The challenges of internationalization in a small firm

Working in X Company for the past two years, several challenges X Company faces were recognized during their business activities. These include challenges faced in both domestic and foreign markets.

The biggest challenge X Company has faced is that their products are mostly manufactured by other companies, while X Company only has the rights to distribute them within Turkey. Conflict of interests happen over who gets to sell the product to foreign companies, as networks created by X Company has been taken over by the main company that sells those products to X Company. This occurrence was seen on multiple occasions where the customer was fond

of the service it got from X Company and business relationship in between, but switched to the main company due to lower prices offered by that company.

Mr. X has said that, X Company was trading regularly with a firm in Uzbekistan. The contact between the two companies was good, and the local firm was content with X Company's service. However the company that owned and sold the goods to X Company (Y Company) intervened after a period stating that they had exclusive selling rights to that country. X Company knew from previous dialogues with Y Company that they did not have such a right before. When Y Company found out that it was viable selling in Uzbekistan, they took over the trade and gave the contact in Uzbekistan the exclusive selling rights in 2011. However after three years, by the end of 2013, the local firm got in contact with X Company once again while stating that they were unhappy with Y Company and wanted to buy the products from X Company.

Pedersen (2000) state that the external competitiveness of the international markets has an impact on the progress of the internationalization of firms. While competition can occur through firms that are natural competitors (rivals) in a market, they may also come from within a firm's own network. Johanson and Vahlne (2009) note that firms often have close and long lived business relations with their suppliers and customers. They add that this web of interactions between different firms and their own networks creates the web of connections that the authors have named business networks. The authors argue that "insidership" is gained when a firm is well positioned within a network and has gathered trust in the network and has invested in the network with their commitment. As trust and commitment is a vital part of international business fostering and being an insider in a network, any actions within the network that harms the trust of a firm will harm the business activities of the firms related in that business connection.

Currently X Company is embarking on a path where it will manufacture its own specialized goods in order to market and sell the end product on foreign markets. This strategy will allow X Company to find and utilize new networks for their internationalization.

Another challenge X Company faces is the economic hardships in the domestic market. With the company's main source of income depleting because of increasing competition, its profits decreasing due to increasing overhead costs and declining margins between the cost of the goods and the prices of the goods; the economic situation of the company does not allow for huge investments at the given time. Also considering that the cash-flow of the company is getting less fluid with the due date of income gets farther away each year, the company needs to be highly conservative of how it spends its money. Coupled with the economic and politic disturbances in the domestic market, this forces X Company to be extremely risk averse.

It is noted by Gankema et al. (2000) that stagnation may occur for small firms because of economic reasons in their domestic markets. They note that this stagnation can postpone the improvement of the firm's status in the international market. It is vital to note that long and hard periods of stagnation within the domestic market for firms with strong domestic markets and relatively high overhead costs could lead to firms being unable to internationalize entirely as Clerq et al. (2005) notes that increasing domestic learning focus is inversely related to internationalization success. Gallup Organization (2007) has found that lack of capital is the second biggest constraint after lacking market knowledge for SMEs to their exporting activities. It was also the highest reported constraint by the Turkish firms according to the same study.

X Company is a lean structure, where the employees can exercise their judgment on smaller business decisions. Reaching the general manager of the company is easy, and he can be consulted on matters where the employees do not want to take charge. While this creates a favorable working environment for the employees, it has a downside on the internationalization process. The internationalization process requires the management's high attention. There are

strategies to map out, budgets to create and review goals to decide on, marketing actions to be decided, networking activities to be made, desired foreign markets to be chosen, knowledge on specific foreign markets to be obtained, overall knowledge on functioning on the international markets to be obtained. These not only require funding, but they also require the attention of the management of the firm. However, the management involvement in increasing the international exporting of the firm and finding new markets has been low due to the challenges of the daily business life in the domestic market.

Clerq et al. (2005) states that top management's entrepreneurial activities hold a vital position in the internationalization process of a firm by directing the scope of the firm to a more global position. Gankema et al. (2000) states that the experience of management is positively related to the success of the internationalization progress of a firm. Reuber and Fischer (1997) notes that the experience of the management for progressing on the stages of internationalization for SMEs that operate within a large domestic market is even more vital compared to the other small firms. Given that X Company is in an industry with a large domestic market, the management experience and involvement in the internationalization process is a must. Given that the involvement is on lower levels, this presents itself as a challenge for international growth.

Observing X Company's strategies for the foreign market, two types of entry methods seem to be taking hold. They are either exporting the finished goods through an agent, or turnkey projects through contractual work in which the exported goods' installation will be undertaken by either X Company employees or through outsourcing during which X Company employees will be overseeing the installation. It should be noted that, all the turnkey projects X Company has accessed was a collaborative work with a network company.

X Company has chosen low psychic distance countries to export to. It has chosen indirect exporting through an agent for ease of transportation and for following customs regulations without actively getting engaged in the foreign market's rules and regulations. Thus the agent takes control over the transportation, marketing and customs tasks for the exporting, while X Company focuses on obtaining and preparing the goods for exporting.

X Company is recently undertaking international projects in countries with larger psychic distance utilizing connections with networking companies. Using the experience of companies within its network, X Company is able to gain valuable market information on distant markets. This not only allows for the knowledge barrier to diminish, but also allows X Company to find new networks in the focus market.

In the gradual internationalization method of stage theory of Gankema et al. (2000), X company's method of business in the international markets shall be considered as active involvement. X Company has an export/sales ratio of about 10% and is currently working together with its network companies to find and exploit new opportunities in the international markets. It has a steady export rate through its agents in low psychic distance countries. The reasoning behind exporting through an agent, which is called indirect exporting, according to Albertini et al. (2011) is that indirect exporting is the least risky method of internationalization. Johansson et al. (2008) states that with indirect exporting the firm has lesser control over the marketing process and Osland et al. (2001) points out that the task of intermediaries during indirect exporting is the transport and the marketing of the products. Albertini et al. (2011) adds customs clearance as a task for the agents in indirect exporting. Using networks to overcome barriers of knowledge and psychic distance has been stated in the network theory by Johanson and Vahlne (2009). They have proposed in their revised version of Uppsala model in 2009 that every market is a network of relationships where firms are connected to each other and that through these connections firms can obtain new knowledge, build trust and increase their commitment, which are the key determinants put forward by Johanson and Vahlne (2009) for a successful internationalization.

6. Conclusion

The SME in question had been a global importer since its inception. It has, in the past, participated in all beginner stage internationalization activities except proactively seeking international customers. It had sought profitable networks, good contacts and like-minded suppliers. It invested into building a profitable supply chain and built knowledge from its past experiences on the challenges of international business activities. The challenges the firm has faced in the internationalization process can be summarized as lack of managerial commitment to internationalization and non-domestic markets, lack of ownership of marketed products, lack of knowledge on marketing and fostering networks on the international stage, lack of trust and cooperation in the firm's own network, and lack of trust and building insidership with new networks in foreign markets. In addition, due to the "liability of outsidership" and "liability of foreignness" of Johanson and Vahlne (2009) it can be seen that the perceived cost of internationalization is an important deterrent.

There has been little research into internationalization of SMEs. Most research tries to answer the "what" questions. These are achieved through surveys. The "how" and "why" questions are not as common and these require case studies and qualitative research instead of quantitative research. The application of prior research into local firms could be found through this study. The research will allow finding the challenges during the stages of internationalization in the applicable firms alongside of seeing theory in action and benefiting from real life experiences.

This research puts forward the differences between the perceived challenges in the firm compared to the challenges found in literature for SMEs during internationalization processes. The data is gathered through interviews with multiple employees and through careful observations. The employees have differing views on the challenges and on the solutions for these challenges the firm has faced during the internationalization process. As such, these multiple views within the company will also give a unique perspective on the steps the firm undertakes in order to overcome the problems of internationalization and, more importantly, how these steps are communicated across the firm from the management to the employees.

This research presents usable data stemming from past experience of a small firm that went through a gradual internationalization process. Literature on SMEs tends to focus on developed countries. Research on SMEs at developing countries is fewer. As such, this study will help the researches looking into the business practices and challenges faced by SMEs in a developing country, namely Turkey.

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