# Measuring the Performance of International SMEs – A Scoping Study

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## Abstract

Whilst internationalization has long been considered an important aspect of entrepreneurship research, only few studies exist on the potential linkages between internationalization and performance among small and medium sized enterprises (SMEs). The analysis of the research presented in this paper suggests that there are at least two categories of factors that constitute potential performance measures for SMEs seeking to expand beyond national borders: qualitative and quantitative ones. Since qualitative aspects of internationalization performance have thus far been largely neglected in the extant literature, this topic appears promising for further research. Applying a case study approach we assess the performance measures applied by young internationalizing ventures as well as by rapidly internationalizing mature firms. One important lesson of this work is that much more work needs to be done to fully comprehend those factors which might serve as purposeful measures for international performance. At best this paper presents only a glance at a situation that is both highly complex and continuously evolving for SMEs.

## Introduction

According to several authors, firms venture abroad in order to improve their performance [e.g. see Beamish et al. (2003), Kim *et al. (1989; 1993),* Ghoshal (1987), Kogut (1985)]. Being one of the most addressed research problems in the field of international management, approximately a hundred studies have investigated the question of whether and how internationalization affects firm performance (Ruigrok et al., 2007). Yet, these studies have by and large been conducted among large, often publicly listed companies. Whilst internationalization has long been considered an important aspect of entrepreneurship research, few studies exist on the potential linkages between internationalization and performance among small and medium sized enterprises (SMEs). What is more, the question of how to measure the performance of internationalization has largely been neglected in literature thus far. Considering that “[s]maller business are not smaller versions of big business” (Shuman et al., 1986, p.8), and that smaller enterprises deal with a unique set of size-related issues, it must be questioned whether performance measures used by large firms, are also applicable to SMEs.

The purpose of this paper is twofold: First, it attempts to frame the critical issues and questions SMEs face when attempting to measure the success of their geographic expansion. Second, the paper attempts to identify and broadly categorize some of the relevant measures for internationalization success. This paper represents work in progress and a “report from the field” as the topic of performance measurement of the internationalization process is constantly evolving.

## Review of the literature

### *Internationalization*

According to Baronchelli and Cassia (Baronchelli & Cassia, 2008), there are two major approaches to the internationalization of the firm: the stage approach (companies start selling products in their home markets followed by looking at new countries) and the born global approach (companies start their international activities from their birth). For the stage approach there are two main models: the Product Life Cycle Theory (Vernon, 1966) and the Uppsala Internationalization Model (Johanson & Vahlne, 1977; Johanson & Vahlne, 1990).

Vernon (1966) considers the internationalization process of the firm to follow the development of the Product Life Cycle: companies usually introduce new products only in their home market and then they eventually go abroad in the product maturity phase.

In the **U-model**, the process of internationalization is described as "a gradual acquisition, integration and use of knowledge about foreign markets and operations and a successively increasing commitment to foreign markets" (Snuif, 2000). More exactly, Johanson and Wiedersheim-Paul(1975) regard internationalization as a slow and incremental process whereby internationalizing firms pass through four distinctive stages, each level reflecting different degrees of involvement in the foreign country: no regular export activities, export via independent representatives, establishment of an overseas sales subsidiary and finally overseas production / manufacturing units. Furthermore, Johanson and Vahlne (1977) developed a model that considers internationalization as causal cycles in which knowledge about foreign markets and market commitment are affected by the firms's current activities and commitment decisions. Moreover, Johanson and Vahlne (2003; 2006) add some other factors to their model: business relationship learning and commitment; commitment and opportunity development. Business relationship learning and commitment enable the companies to enter new markets in which they can develop new relationships which give them a platform for entering other country markets. The commitment and opportunity development is positively related to mutual relationship commitment with firms in the market and to the partner firms' network in the market.

Companies that enter foreign markets typically face a range of costs associated with their international expansion. In a first phase these costs include learning costs in general, but more specifically also costs for adjusting to the foreign environment. This concept which is referred to in the literature as "the liability of foreignness" (Zaheer, 1995) considers that new entrants typically display a lack of familiarity with legal, social, and economic conventions, as well as consumer preferences and cultural features of the targeted foreign markets .

In a second phase, firms that enter foreign markets are typically obliged to adapt their routines and processes to function within these markets. When further entering subsequent markets these companies usually do benefit from the experience they had previously made with market entries (Vermeulen et al., 2001), yet these ventures are nonetheless confronted with the tasks of adapting some of their existing routines and creating some new ones in order to optimally serve this foreign market. Though beneficial to the development of capabilities, these adaptive changes in routines are costly undertakings. Routine generation and adaptation will consume additional resources (Mitchell et al., 1994) that can be significant and long-lasting and in the worst case fatal to the venture (Singh et al., 1986).

In a third phase companies regularly incur yet additional costs associated with their internationalization. These costs stem from an increased organizational and environmental complexity which leads to incremental costs for governance, coordination, and transaction that may outweigh the benefits gained from internationalization (Zaheer et al., 1997). In addition, internationalization increases firms' exposure to financial and political risks resulting from currency fluctuations, governmental directives, and trade regulation (Reeb *et al.*, 1998; Sundaram *et al.*, 1992)

In other words, SMEs that go abroad lack the positional advantages of their mature and well established competitors (Hannan, 1998; Stinchcombe, 1965). Making up for the lack of routines and the positional disadvantages is costly and will add to the mortality hazard of the internationalizer (Mitchell et al., 1994). Hence, the question whether to expand internationally or not is a crucial question that should be pondered well by any SME management. However, instrumental to this decision is an idea of how to actually measure the success of the internationalization efforts. SMEs must be aware of how to appraise their internationalization performance.

***Performance***

The literature provides a variety of means of **performance measurement** and also many ways of its classification. For example, Madsen (1987) classified the performance in four groups: export profitability, export volume, export growth and other indicators, such as perceived success. On the other hand, Dennis (1990) distinguished qualitative performance (perceived success) from quantitative performance (for example, volume export). Furthermore, the measurement of the dependent variable export performance has evolved significantly over time in two directions: firstly, by using multiple measures instead of single measures, and, secondly, by incorporating subjective measures next to objective ones (Voerman, 2003).

The link between the internationalization and the performance of ventures has sparked widespread research throughout the last thirty years. Researchers have not only provided literature reviews on that topic [e.g. see Annavarjula *et al. (2000)* or Ramaswamy (1992)], but also meta analyses on the internationalization-performance relationship [e.g. Bausch et al. (2007)]. Yet, despite being the subject of extensive discussion in the strategy and international business area over the past three decades, findings on the magnitude and direction of this relationship have been inconsistent and contradictory (Annavarjula *et al.*, 2000; Capar *et al.*, 2003; Contractor *et al.*, 2003).

The link between performance and the degree of internationalization has been examined by various scholars in an attempt to empirically prove the theoretical argument that international expansion represents a precondition for superior financial success. Seeing internationalization only as beneficial to a firm, the first studies conducted in the 1970s and 1980s hypothesized a linear relationship between the degree of internationalization and firm performance [e.g. see Grant (1987)]. Later research conducted during the late 1980s and 1990s suggested an inverted-J curve of the internationalization-performance relationship, hypothesizing that there could be a point in a ventures' foreign expansion process at which international complexity starts to burden managerial and organizational capacity (Daniels et al., 1989; Gomes et al., 1999) . Yet, even this position did not remain unchallenged for long, for other researchers found evidence in support of a U-shaped form of the internationalization-performance linkage (Capar *et al.*, 2003; Ruigrok *et al.*, 2003), whilst yet others determined facts substantiating an inverted U-shaped form (Geringer et al., 1989; Hitt et al., 1997). In recent years scholars have partially consolidated these apparently contradictory evidence by suggesting that a horizontal-S curve best describes the internationalization performance relationship (Contractor *et al.*, 2003; Lu *et al.*, 2001).

Additionally, Julien and Ramangalahy (2003), using a sample composed of 346 exporting manufacturing SMEs, found that their performance is determined by their access to and management of foreign market information which can be translated into their competitive strategy.

Knight and Cavusgil (2005) suggest that entrepreneurial orientation, technological leadership and the strategies of differentiation and focus are the key drivers for superior international performance in Born Globals.

In order to see the differences between SMEs that export and the ones that develop their activities solely within their domestic markets, St-Pierre (2003), conducted a comparative study which led to several noteworthy findings: the size of the business influences the potential for exporting, the diversity of a firm affects its export destinations, and international SMEs are more profitable and more innovative than their domestic peers. Moreover international SMEs also have a larger network.

On the other hand, Sapienza, Auto, George and Zahra (2006) suggest in a conceptual paper that early internationalization will decrease the likelihood of survival and increase the venture's sales growth. Effects that are influenced by three other factors: organizational age, managerial experience and resource fungibility. Firm age, prior international managerial experience and fungibility of the firm's endowments will decrease the negative effects of internationalization on the probability of firm survival and it will increase the positive effects of internationalization on the probability of firm growth. Furthermore, Fernhaber and McDougall-Covin (2010) verified Sapienza's et al. (2006) propositions through a study made on 176 new high-technology ventures and confirmed the existence of **curvilinear relationships** between survival and internationalization and between sales growth and internationalization. More specifically, survival exhibited an inverted U-shaped relationship with internationalization, while sales growth held a U-shaped relationship with internationalization.

The varying outcomes of those studies may be partly contributed to differing operationalizations of the main variables, internationalization and performance (Sullivan, 1994). Yet, whilst for both factors various measures were used, common patterns emerge. In their analysis of 36 studies, Bausch et al. (2007) list the most frequently used measures. From this analysis it can be concluded that the vast majority of studies operationalized internationalization as "foreign sales to total sales" or derivatives hereof.[1] Performance was mainly measured by using rentability figures such as Return on Assets (ROA), Return on Sales (ROS) or Return on Equity (ROE). Sales growth was used as the next most frequently used figure.

### ***International New Ventures or Born Globals and Reborn Globals***

The rather recently discovered phenomenon of Born Globals (Rennie, 1993), International New Ventures (Oviatt & McDougall, 1994) or Global Start-Up, has prompted calls for the revision of received internationalization theories (Oviatt *et al.*, 1997). The term refers to ventures that strive for a rapid international growth from early on in their corporate lives and that pursue a Global strategy from

[1] (such as foreign subsidiary sales to total sales or export sales to total sales)

inception (McDougall *et al.*, 1996; McDougall *et al.*, 1994; Oviatt *et al.*, 1994, 1997). More specifically, and according to Oviatt and McDougall (1994, 46), an international new venture is defined as ”a business organization that, from inception, seeks to derive significant competitive advantage from the use of resources and the sale of output in multiple countries. The distinguishing feature of these start-ups is that their origins are international, as demonstrated by observable and significant commitments of resources in more than one nation”. One year later, Oviatt and McDougall (1995), added a list of important characteristics for a successful international new venture: a global vision from inception, managers with previous international experience and strong international business network, pre-emptive technology or exploited marketing, unique intangible asset, a strong link between product or service extensions and their unique asset, and a closely coordinated organization worldwide.

Accordingly, international new ventures or Born Globals regularly display a rapid and dedicated internationalization pattern which is often fuelled by the wish to make use of a ‘first mover advantage’ and to ‘lock-in’ new customers (Bell et al., 2001). Furthermore, a strong motivating factor is the urgency to speedily exploit proprietary knowledge as the main source of competitive advantage. This is even more so the case in sectors where rapid technological transformation, coupled with the difficulty of protecting intellectual property, narrow the time frame of commercial opportunity (Bell et al., 2001).

The extant literature provides evidence that firm internationalization may be spurred by particular ‘episodes’ that can lead to rapid international expansion or de-internationalization (Oesterle, 1997). Particular incidents, such as emerging opportunities in international markets, favorable exchange rates or an unfavorable economic situation in the domestic market, many prompt ventures to rapidly internationalize (Bell et al., 2001). Consequently, firms may go through periods of swift internationalization, followed by periods of consolidation or even retrenchment.

As an extension to the existing Born Global research, Bell et al. (2001) have identified the existence of what they labeled ‘Born-again’ Global firms. Bell et al. describe these as companies that have been well established in their home markets, with apparently no great motivation to go international, but which suddenly embark on a speedy and bold internationalization journey. Their underlying motivations are essentially the same as those of Born Globals, yet the swift move beyond national borders happens rather late in their corporate life.

## Methodology

As mentioned above, this research strives to pinpoint critical issues and questions SMEs face when attempting to measure the success of their internationalization efforts and to identify and broadly label some of the relevant measures for internationalization success. Hence, and being of exploratory nature, this work is built on a qualitative approach.

### *Case Selection*

Participants of our study comprised a sample of 4 companies from a variety of industrial sectors and company sizes. The firms were selected through purposeful sampling (LeCompte *et al.*, 1993; Patton, 1980). This criterion-based selection method allows a structured sample that fits a predefined profile to be generated (Barringer *et al.*, 1998). Companies included in the sample had to be either Born Globals or ReBorn Globals, private, and to qualify as SMEs.

Moreover, we set great store by selecting firms that represented polar categories in terms of their internationalization behavior (Eisenhardt, 1989). Using "types" (Eisenhardt *et al.*, 2007) rather than adopting replication logic  (Yin, 1989) ensured that theoretical classes (Eisenhardt, 1989) were filled. In particular, three firms represented the ideal type of "Born-Global" firms whilst another one represented textbook "reBorn Global" type.[2]

### *Data Collection and Coding*

The data essential for this study was primarily collected from interviews. A first session of Interviews was held in 2006 (April – June) and a second session with the same persons in 2009 (June – September).Where applicable, additional archival sources were consulted. In-depth interviews of a duration of approximately two hours were conducted with a senior manager and a second person involved in strategic decisions from each of the companies following a predesigned outline. Supplemental archival data included information published on the Web, company brochures, documents, and magazine or newspaper reports. Whenever possible the interview data and the data obtained from the archival sources were triangulated, revealing a high level of consistency (Denzin, 1988; Janesick, 1994).

## Results

### *Company A*

**Internationalization History**. Company A is a family-owned business that provides products and services for luminous advertising. Initially focusing on the production of neon tubes, it expanded its scope into planning and implementation of visual communication strategies and developing corporate identity concepts.

The origins of Company A date back to 1977 when the business was still part of the operations of a larger firm and taken over by the current owners. It initiated its first geographic expansion in 1989 when it boldly ventured into the German market by acquiring a German firm of similar type. This rather late move, combined with the significant revenues it generated abroad henceforward, is typical for a Reborn Global.

Germany was chosen for the close geographic proximity to Switzerland, as well as the close cultural fit. Moreover, Company A had already existing client relationships in Germany at that point in time. Over the next 14 years Company A established itself in most parts of Europe, before expanding Globally in 2003. Here, too, the already existing client relationships were a major incentive. Today Company A operates affiliates in six different countries as a holding and supplies the rest of the world from these six countries. The group has a total of 500 employees of which 340 work in Europe, while 160 work in Switzerland; a small number of employees work in China.

[2] Note that this is work in progress; further types will be included in the research sample.

When internationalizing, scale effects played a major role for Company A. Cooperating internationally allowed Company A to not only focus more closely on the client, but also to render their services more efficiently. Learning from other cultures and understanding their way of conducting business provided Company A with the opportunity to expand its know-how and to build up further competencies. Whenever possible, Company A tried to learn from the given situation abroad und tried to use it to its advantage.

**Performance Measurement**. Company A measures the performance of its internationalization efforts in several ways. Turnover is used as the main financial measure. Furthermore client feedback is gathered in a structured way and the efficiency of operations is regularly tracked by calculating the corresponding actual operations figures and comparing them to anticipated numbers.

***Company B***

**Internationalization History**. In 1965 Company B was founded as a family company providing engineering services. Over time it has developed into a company developing and manufacturing highly sophisticated shakers and fermenters for biotech firms.

Due to a less developed home market and a lack of domestic demand, the company was obliged to conduct international business from the beginning and thus qualifies as a Born Global. Today Company B has five affiliates in Western Europe, a shell company in the US as well as diverse partnerships. Other markets are served by exporting to dealers in the specific countries. In total 130 employees work for Company B of which 30 work abroad. Approximately 90% of all clients are domiciled abroad.

The management of Company B considers personal contacts the most important factor for internationalization; almost the entire current contract volume stems from personal ties established throughout the development of the firm. Cold calls, etc., play no role for the current quantities ordered.

Acquiring new competencies and developing new capabilities, such as customer oriented processes is considered to be the largest benefit gained from internationalization. The diversity of client demands in the various countries forces Company B to display a high degree of client centricity. Adjusting the process to optimally serve diverging international client needs is therefore seen as a key capability which provides the firm with the necessary flexibility to strive in different contexts.

**Performance Measurement**. In the case of company B, the financial figures, such as turnover and profit, etc., are the prime measure for international performance. Second, market share as well as brand awareness are used to determine internationalization success. Despite being very hard to operationalize, know-how gains are also used to evaluate the results of venturing abroad.

***Company C***

**Internationalization History**. Company C is a highly specialized venture which develops and produces laser-based cutting systems. The business was founded in 1997 following the discovery of the underlying technology in 1993. The clients of Company C are Globally leading manufacturers in the areas of semiconductors, photovoltaics, LED-displays, medical appliances, automotives, as well as machinery tools and watch producers.

Facing a rather limited domestic market from the start, Company C has been internationally oriented since its foundation. For this purpose it had initially established a strong distribution and service network in Switzerland, complemented by sales agents and distribution partners abroad. As such, it constitutes a typical Born Global. Yet this setup has changed over time. In order to better accommodate their client needs, Company C applied a stronger regional approach and established affiliates abroad. Today Company C is active in 15-20 international markets with subsidiaries in the US, China, Japan and South Korea. The total workforce comprises 75 employees, of whom 15 work abroad.

Company C cooperates in numerous partnerships and maintains a wide network of suppliers. These alliances foster prototyping, product display, and R&D in general. Nevertheless Company C sets great store by assembling the final product. In this way it can remain highly client-focused and can flexibly fulfill individual client requests whilst keeping at bay other tasks it does not consider its core capability.

**Performance Measurement**. Company C considers the development of competencies the biggest benefit of its internationalization efforts. It constantly strives to further expand these competencies by engaging the networks mentioned above. According to the management of Company C, a whole range of products emerged explicitly from international cooperation with partners from numerous countries. As a side effect of international expansion, Company C also considers economies of scale as one of the major successes of its internationalization efforts. Another important aspect indicating the success of internationalization is – according to Company C's management – a high degree of client satisfaction. Since Company C is a niche player which serves numerous Global companies, it views its international scope as a condition *sina qua non* for achieving the highest possible degree of client satisfaction. Last but not least, employee satisfaction is an important aspect in Company C's internationalization activities. Despite its rather small size it can offer its employees an international development path which provides a substantial competitive advantage over other SMEs which are not as international.

### *Company D*

**Internationalization History**. Company D is a wholesale company that supplies compressed hard metal objects, such as cutters, tubes, bent pipes, coolant bores and unnotched specimen which are typically used in the production processes of other industry firms.

The business was founded in 1980 and initiated its first geographic expansion to Germany, the UK and Italy in 1981. This was accomplished using direct exports as well as wholesalers and sales agents. Due to its early moves into the international arena it can be considered a Born Global. Currently Company D is active in seventeen countries through agents. Furthermore it operates subsidiaries in the US, in Germany, France and Spain. Today it employs a staff of 200, of which 160 are located in Switzerland. A further 30 are employed in the US and an additional 10 appointees work in the different European locations.

From early on foreign clients approached Company D asking for their products, spurring the speed of its internationalization. This period of rather uncoordinated international expansion lasted until

1996, at which time a structured approach was applied. The management defined specific targets which countries to approach, the market share it was striving to obtain, and which competitors to concern to potentially engage in alliances. Furthermore, the firm's management specifically targeted countries that were not only highly developed and familiar to the administration, but also whose languages it could speak. The management was convinced that only in such countries could it provide the highest degree of product quality and yield the corresponding revenues.

**Performance Measurement**. Economies of scale were named as one of the most important benefits derived from internationalization. Catering for a larger market allowed Company D to extend its volume and thus to reap the corresponding benefits from a larger scale of production. Another important success indicator of the internationalization efforts of Company D is risk diversification. Serving a broad range of countries allows Company D to rebalance sales efforts should one or several markets develop adversely. In this way the revenues of Company D are less susceptible to market volatilities.

An additional major gain from internationalization is the development of competencies through close cooperation with foreign clients and suppliers as well as universities abroad.

Apart from these success indicators, Company D considers financial figures an appropriate measure for internationalization success. It therefore tracks financial measures such as revenues, overall and costs,  and keeps a close eye on the prices it can demand for its products in the specific markets.

Next to these benefits, Company D appreciates the increased client satisfaction it achieves through being closer to its foreign clients and the improved employee satisfaction it arrives at by offering an international career path and a multicultural work environment.

A summary of the individual case studies is provided in Table 1.

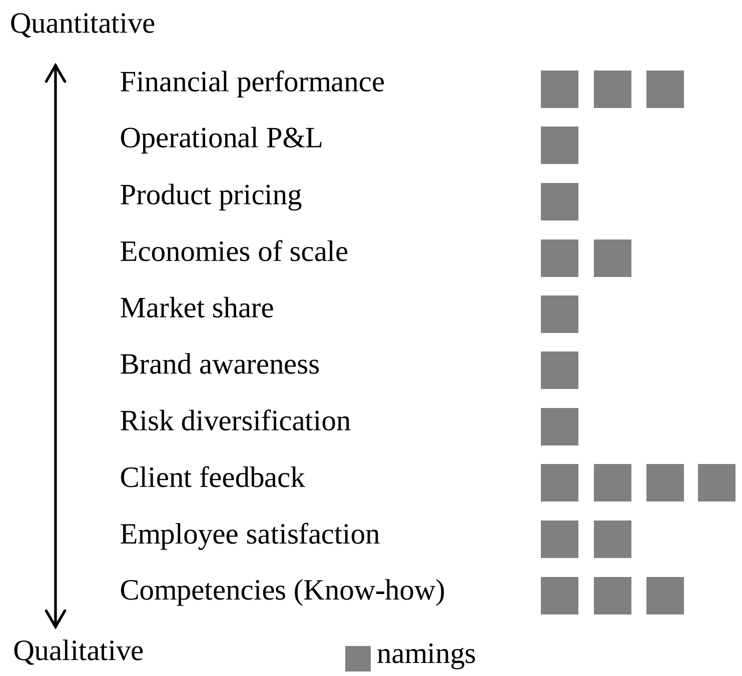
Table 1: Summary of individual case studies

| | **Company A** | **Company B** | **Company C** | **Company D** |
|---|---|---|---|---|
| **Products / service focus** | Luminous advertising | Biotec equipment | Laser technology | Hard metal products |
| **Year company founded** | 1977 | 1965 | 1997 | 1980 |
| **Year of first international expansion** | 1989 | 1965 | 1997 | 1981 |
| **Internationalization type** | ReBorn Global | Born Global | Born Global | Born Global |
| **Number of employees total** | 500 | 130 | 75 | 200 |
| **– of which in Switzerland** | 170 | 100 | 60 | 160 |
| **– of which abroad** | 330 | 30 | 15 | 40 |
| **Means of performance measurement** | Client feedback<br>Financial performance<br>Operational P&L | Financial performance<br>Market share<br>Brand awareness<br>Know-how<br>Client satisfaction | Competencies<br>Economies of Scale<br>Client satisfaction<br>Employee satisfaction | Economies of Scale<br>Risk diversification<br>Competencies<br>Financial performance<br>Product pricing<br>Employee satisfaction<br>Client satisfaction |

### *Results of Analytic Induction*

Following the stepwise approach suggested by Cressey (1971) we analyzed the data from the four case studies. The analyses of the cases revealed findings that corroborated and contradicted earlier findings. Indeed, some of the survey companies did measure performance in terms of quantitative financial figures as Bausch et al. (2007) had acknowledged. Yet, additional qualitative figures are just as important to internationalizing SMEs, if not more important. Client satisfaction, for example, was named as a measure for international performance by three of the four survey firms. Similarly, know-how gains or competencies development were stated as important measurements for international performance (see Figure 1). These qualitative factors have not been captured in previous studies on internationalization performance.

Figure 1: International performance factors of SMEs




## Conclusions

Swiss SMEs represent the backbone of the Swiss industry. Increasingly they are seeking to expand their business into international markets, which puts additional strain on their comparably limited resources. This paper has identified the existence of alternative, mainly qualitative, measures of internationalization performance. Although the research described is essentially exploratory in nature, there is sufficient evidence from the findings to warrant a much fuller investigation into the measurement internationalization performance of such firms and into the nature of their attempts to assess the effectiveness of their undertakings.

The analysis of the research presented in this paper suggests that there are at least two categories of factors that constitute potential performance measures for SMEs seeking to expand beyond national borders: qualitative and quantitative ones. Since qualitative aspects of internationalization performance have thus far been largely neglected, this topic appears promising for further research.

Our final conclusion is that much more work needs to be done to fully comprehend those factors which might serve as purposeful measures for international performance. At best this paper presents only a glance at a situation that is both highly complex and continuously evolving for SMEs. For this reason this research intentionally provides a number of view- points from a range of entrepreneurial organizations. These, among many more not touched upon here, contribute to the larger issue of how performance is actually measured by the practitioner entrepreneur in Switzerland today. The potential levers and constraints identified on the basis of the analysis of the research will be used in follow-up work that will focus on further refining performance measure for the internationalization of Swiss SMEs.

## Limitations and Research Directions

All studies come with limitations. In our case the use of a purposeful sample certainly limits the study's generalizability. Yet, researchers often use such samples to strengthen the internal validity of a study which potentially requires either a high degree of comparability or diversity among the research subjects [e.g. Barringer *et al.*(1999), Brews *et al.*(1999)]. In this study, the purposeful sampling method provided two important methodological advantages. On the one hand, it allowed for selecting information-rich cases for indepth study and on the other hand, it permitted a minimum of variation to be introduced. Yet, this study will include further companies to further investigate the preliminary findings. A further research direction emerges from a quantitative research perspective. A large sample survey covering a wide range of different industries in various regions of Switzerland would further enhance the generalizability of any findings. Furthermore it could also be of interest to understand whether the performance measurement of internationalizing Swiss firms differs from those of ventures residing in other countries. For this purpose an international comparative study would certainly be highly beneficial.

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