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# **OPERATIONS OF FINNISH SMES ON EMERGING MARKETS**

**Advantages and challenges**

Master's Thesis  
in International Business

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## LIST OF ABBREVIATIONS

BEM	Big emerging market
EU	European Union
FDI	Foreign Direct Investment
GATT	General Agreement on Tariffs and Trade
GDP	Gross domestic product
GNI	Gross national income
GNP	Gross national product
IMF	International Monetary Fund
LDCs	Least-developed countries
MNE	Multi-national enterprise
NIE (or NIC)	Newly-industrialized economy (-country)
SMEs	Small- and medium sized enterprises
TDI	Trade and development index
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
WTO	World Trade Organization

## 1 INTRODUCTION TO THE STUDY

In this first chapter, the topic and purpose of this study are introduced. After this, research problem will be presented. Short definition of SMEs can be found in the last subchapter.

### 1.1 Background

The Finnish foreign trade is doing well. The value of all goods exported from Finland on the period of January – October 2007 was 8% higher compared to the same period in 2006. The gross value of exports on that period in 2007 was almost €55 billion, and the trade balance had a surplus of close to €5.5 billion. (Finnish foreign trade statistics 2007)

The countries in new and emerging market areas, such as Asia and Latin America, have proved to be a valuable target not only as places for moving production to, but also as trade partners. For example, the value of exports from Finland to Mexico in January - October 2007 were 9% higher (totalling €162.6 million), and the value of exports to India on that period as much as 40% (€363.9 million) higher compared to the figures of January – October 2007. Furthermore, the trade balance with India had a surplus of over €200 million. Even though both of these trade partners accounted for less than a percent of the value of the Finnish foreign trade, these growth rates should be treated with respect. (Finnish foreign trade statistics 2007)

Several researchers (e.g. Carson, Cromie, McGowan & Hill, 1995) are convinced that SMEs, despite their lack of control over their environment due to their small size, have some advantages over their larger rivals. These advantages include at least the flexibility and innovativeness of SMEs. Could this capability to adapt swiftly prove to be a competitive advantage on constantly changing emerging markets?

At least the Finnish SMEs have proved to be active in exporting as well: from July - September 2007 to July – September 2006, the value of their exports grew by 13%, when larger companies achieved a more humble 4% growth. The small enterprises (companies that have 10 - 49 employees and annual turnover of €2 -10 million) did remarkably well, and they were able to achieve a 25% growth. The growth of SME-exporting was strongest in electro technical and metal industries. (Finnish foreign trade statistics 2007)

Although the share of large companies still covers over four-fifths of the value of all exports (Finnish foreign trade statistics 2007), the SMEs have, as mentioned earlier, increased the value of their exports at a higher pace. In addition, as Nummela (2000, referring to Hurmerinta-Peltomäki & Nummela 1997) points out, the majority (over

80%) of companies involved in exporting can be categorized as SMEs. The statistics prove their claim, 84% of the approximately 9400 companies that were exporting goods from Finland in July – October 2007 were SMEs (Finnish foreign trade statistics 2007).

But growth can not be translated into success nor does it guarantee the future of a company. From this point of view it is rather convincing to find out that, according to an article by Anneli Hertsi (2008), Finnish SMEs are doing well also when using other measurable factors as indicators. Hertsi bases her article to a study by Balance Consulting of 353 SMEs. From this sample, a median company improved its performance from 2006 to 2007 on all four studied indicators, i.e. turnover growth ratio, profit, return on investment and gearing ratio. This research has been carried out annually from year 2003 using the same companies as source for data, and the strong upwards trend has so far prevailed. (Hertsi 2008)

Obviously, no one can neglect the importance of the large companies such as Nokia and Metso for Finnish national economy. Elo (2005, adopting e.g. Luostarinen, 1979) reminds that the large companies have a significant role in internationalization of SMEs through their outsourcing strategies, where smaller partners have an increasing importance. Nonetheless, it can be argued that the smaller actors deserve more attention. They should especially be studied more as exporters, and not only when regarding them as domestic employers. This study aims to do so, as will be presented in the following subchapters.

## **1.2 Purpose and structure of the study**

The purpose of this study is to generate more accurate information on SME operations in emerging economies. The existing theories on doing business in the developing world tend to wield the subject on a more general scale. This research aims more to bringing out the aspect of a more specific group: the SMEs.

It is rather easy to find studies and other publications of the problems SMEs face in their internationalization process. For example, Luostarinen, Korhonen, Jokinen and Pelkonen (1994) list a number of difficulties of internationalization typical to SMEs. Usually, however, these studies concentrate on the fact that due to their size, SMEs usually possess limited resources. However, from the author's point of view there has to something more to it, factors that do not depend on the bank balance or the amount of legal advisors. Surely having a smaller organization can offer possibilities. On the other hand, are all of the difficulties resource-based?

So the question is what advantages and disadvantages in operating on the emerging markets do SMEs have, especially when compared to the large companies? How do SMEs utilize their strengths and, on the other hand, neutralize their weaknesses? And,

above all, what are the factors that lead to the situation where a given company can feel satisfied to its ventures and achievements: which details define the subtle difference between a profitable project and a bitter failure? These critical questions this research aims to answer.

It has to be pointed out that SMEs cannot be considered as a homogenous group. Still there are differences between the internationalization processes of large and smaller companies. It is a somewhat surprising that no conclusive theory of the internationalization of SMEs has been developed. Moreover, existing studies on the subject have inconsistencies, resulting from e.g. whether the research is carried out from European or North American perspective (Nummela 2000, 12).

This research aims to finding out what kind of activities SMEs have in emerging market areas and what are the “keys” to doing profitable business in developing market areas. On the other hand, the challenges SMEs usually face on emerging markets will be studied, along with how they overcome these obstacles. Theoretically, these measures should include at least the support offered to them by e.g. public organizations, and forms of co-operation and networking, especially with each other.

In order to somewhat delimit this study, the research concentrates on situations where a company is selling commodities or services to a country regarded as an emerging economy. Hence, companies that have e.g. merely outsourced their manufacturing abroad will be left with less attention in this research.

Conducting this study begins with setting research problems. The main research problem is “*What are the main advantages and challenges of SMEs in exporting to emerging markets?*” This research problem is divided into three more understandable sub-problems:

1. What kind of operations do SMEs have in emerging market areas and why have emerging markets been targeted?
2. What advantages do SMEs possess in exporting to emerging markets?
3. What are the main challenges SMEs face on emerging markets and how do they overcome them?

These research problems will be first examined through the chosen theoretical framework. After this, the aim is to find out how well they can be made practical in the real-life, i.e. the case-companies’ activities are studied in the light of the theoretical background.

### 1.3 Definition of small and medium-sized enterprises (SMEs)

The concept of small and medium-sized enterprises has not only been specified several times, but it has also been regulated by the European Union. According to the EU, in order to be considered as an SME, a company must fulfil the following terms:

- It must have less than 250 employees, excluding apprenticeship students and trainees.
- Its annual turnover may not be over €50 million and
- The value of its balance sheet may not exceed €43 million (when calculated using the guideline method by the European Union).
- Less than 25% of its equity or voting power can be owned by general government or large companies (latter with some exceptions). (EU regulation 2003/361/EY)

Furthermore, companies can be subcategorized to micro-, small- and medium-sized enterprises. *Micro enterprises* have less than 10 employees and their annual turnover or the value of balance sheet does not exceed €2 million. Companies with less than 50 employees and a maximum annual turnover (or value of balance sheet) of €10 million are called *small enterprises*. Companies exceeding these limitations (up to the limits of SMEs presented above) are categorized as *medium-sized enterprises*. (EU regulation 2003/361/EY)

This research, however, concentrates on the characteristics and actions of smaller enterprises as a whole. Hence these three subcategories will be of little use, and the term SMEs will be used to include all companies that fulfil the standards listed in the first paragraph.

*Emerging markets*, the other key term used widely in this study, is far more complicated to comprehend. Hence the second chapter is dedicated to scrutinize this concept and the level of economic development of a nation.

## 2 DEFINING EMERGING MARKETS

As mentioned earlier, the concept of emerging markets is far from unambiguous. Hence, it is reasonable to look at the different terms and descriptions more or less commonly used to illustrate the level of economic development of nations as these concepts play an important role in this research. It is also important to understand the indicators by which the level of economic development can be measured. First, however, a simple definition of emerging markets will be presented.

### 2.1 Simple definition of emerging markets

The term *emerging markets* (also *emerging economies*) is used to describe the business environment and market activity in industrializing and developing regions of the world. It is challenging to make an exact list of countries that could be described as emerging markets, but often mentioned countries include e.g. China, Latin America and the former socialist nations in Eastern Europe. These countries are seen to be in a transitional phase between developing and developed status. (Emerging Markets)

Often these countries have little in common as nations. Still some experts believe that their role in the world economy and politics is increasing. It is typical for emerging markets that new user groups are constantly arising, and consumers are eager to adopt new products and services. (Emerging Markets)

Although researchers such as C. K. Prahalad and professors from Harvard Business School have studied the development of individual countries (e.g. India and China), a conclusive theory of the subject is yet to be found. Hence it is still little understood how a market actually emerges. (Emerging Markets)

The process of market emergence can be however divided into phases. In a simplified version, an emerging economy goes through four stages of market development: *pre-emerging*, *emerging*, *accelerated growth* and *maturing*. The duration of these phases can vary significantly, depending on the country's individual rate of economic progression. (Miller 1998, 6)

As can be seen, the concept of emerging market is rather vague and deserves more scrutiny. Hence a closer look has to be taken to the discussion around the terms and definitions used to refer to developing economies and geographic areas. This will be carried out in the following subchapters.

## 2.2 Trade and Development Index (TDI)

As some means for comparing the economic status of nations is needed for this research, the United Nations (UN) Trade and Development Index (TDI) will be used. The United Nations Conference on Trade and Development (UNCTAD) has published a similar report also in the year 2005, so TDI can also be used to somewhat study the progress of nations' development.

TDI is composed of 3 dimensions and altogether 13 components, which are further divided into 34 relevant indicators. A value (the higher the better) for each indicator is calculated by using e.g. macroeconomic data. This value is converted into points and the final TDI is then generated by summarizing these points<sup>1</sup>. (Developing countries in... 2007)

The components and indicators that are used to calculate TDI are presented in the following subchapters. Each subchapter presents the components of one of the three dimensions. The names of the underlying components are italicized in the following text.

### 2.2.1 *Structural and institutional context*

In order to do trade, certain basic features are needed to be somewhat in order. Transportation of goods requires roads, harbours and airfields. Producers usually prefer healthy and educated employees and in order to get products sold, consumers must have money to spend. Most traders do not wish for the government to interfere with their business etc. The *structural and institutional context dimension* aims to evaluate these features along with other related characteristics.

The first component of structural and institutional context is *human capital*. It measures how much a nation spends in educating and nurturing its people. Used indicators are health and education expenditures (percentage of GDP<sup>2</sup>). *Physical infrastructure* consists of paved roads (percentage of total roads), air transport (million tons per km) and telephone mainlines (per 1000 population). (Developing countries in... 2007)

By studying the amount of domestic credit to the private sector (percentage of GDP), the level of nations *financial intermediation* is assessed. Gross domestic savings (percentage of GDP) are used to indicate the status of *domestic finance*. The level of development of *international finance* is measured by the amount of total external debt

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<sup>1</sup> Calculating TDI is here presented in a simplified manner

<sup>2</sup> Gross Domestic Product

(percentage of GNI<sup>3</sup>) and further by the share of short-term debt of the total external debt. (Developing countries in... 2007)

The governmental interference on economy and finance is evaluated by *institutional quality*. This is assessed using two indicators: regulatory quality measures the effect of government to finance and trade (e.g. the presence of market-unfriendly policies), and control of corruption the motive and means of the government to fight corruption (e.g. the grey economy and bribery). (Developing countries in... 2007)

*Economic structure* reflects the amount of refining done to agricultural products within a nation. It is measured by calculating the agricultural value added (percentage of GDP). Depletion and degradation of natural resources is not taken into account. *Environmental sustainability* is assessed by access to improved water (percentage of population with reasonable access to water), access to improved sanitation (percentage of population with adequate access to excreta disposal facilities) and energy use (PPP<sup>4</sup> GDP per kilogram of the oil equivalent of energy use). (Developing countries in... 2007)

Two indicators are used to evaluate the *macroeconomic stability* of a nation: the more important one is consumer price index (annual percentage), i.e. inflation. The second indicator, current account balance (percentage of GDP) is the sum of net exports of goods and services, net income and net current transfers. (Developing countries in... 2007)

### 2.2.2 *Trade policies and processes*

Politics can make life hard for private companies. If the government of a nation decides to impose harsh tariffs on imports it makes the country a less lucrative target for export operations. For some reasons other nations may also aim to block a given nation partially or entirely from international trade. *Trade policies and processes dimension* evaluates these features.

*Openness to trade* is evaluated solely based on the level of imposed tariffs. Weighted mean tariff is the average of applied rates weighted by total imports. The amount (percentage) of exceptionally high tariffs is monitored by calculating the share of lines with national or international peaks. Share of lines with specific tariffs (percentage) represents the amount of tariffs that are set on per unit basis. (Developing countries in... 2007)

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<sup>3</sup> Gross National Income

<sup>4</sup> Purchasing Power Parity

Furthermore, tariffs are used as indicators to measure the level of *access to foreign market*. The indicators are the same presented in the previous paragraph, but are calculated based on the tariffs set by the trading partners of the nation under evaluation. (Developing countries in... 2007)

### **2.2.3 Trade and development performance**

Pioneers usually do the hardest part of spreading business into new areas. It is usually easier to access new markets if international trade is already appreciated in the target country. The level of social development somewhat determines what services and commodities are or could be in demand. These aspects are evaluated by the *trade and development performance dimension*.

The amount of exports and imports of a nation reflects to its *trade performance*. The observed indicators include merchandise- and service exports (percentage of world exports), market concentration index for merchandise exports (dependency or independency on core products) and total trade (exports and imports, percentage of GDP). (Developing countries in... 2007)

Development performance is measured by *economic and social well-being*. It takes into account senior welfare index (based on either expenditure or income), adult literacy rate (percentage) and life expectancy in years. The equality between men and women is also monitored, using female-to-male income ratio (percentage) and the share (percentage) of female workers of the total labour force. (Developing countries in... 2007)

## **2.3 Categorizing countries by their level of (economic) development**

TDI takes into account many indicators and, even though being a rather complex tool to comprehend and criticize, gives a clear numerical value of the level of development of a given country. Figure 1 presents a simplified version of the development process. Actually, it virtually consists of the same elements as the TDI; they are just presented in a stripped-down form.

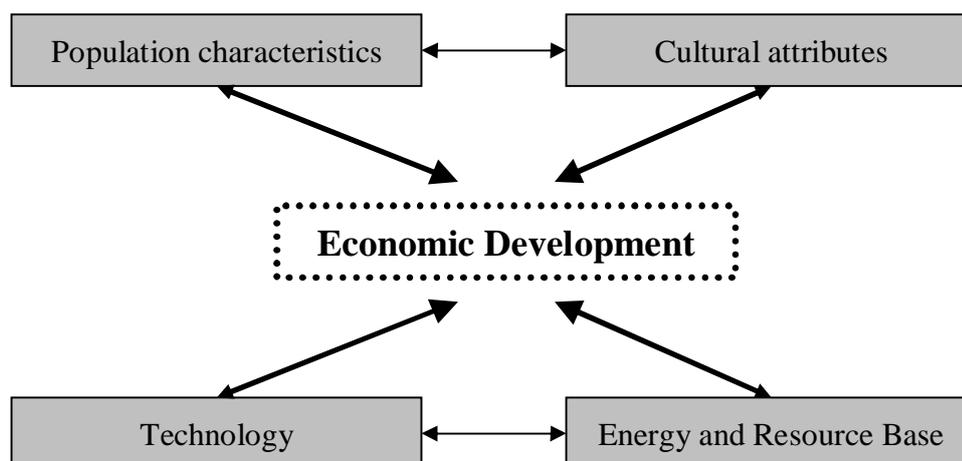


Figure 1 The economic development process (Wheeler, Muller, Thrall & Fik 1998, 38)

In figure 1, the cause- and effect relations are presented as arrows. This model adds cultural attributes to the development process, as TDI only evaluates the political attitudes in a country.

But as can be deduced from the previous subchapter on TDI, defining the actual level of economic development of a nation or region is far from being simple. In this chapter however, some established concepts and terms are presented. Here, for evaluating a nation's level of economic development, TDI is used as a primary tool, yet supported by other indicators.

### 2.3.1 *The concept of the Third World*

Third World is often used as a synonym for the developing countries. This term comes from the somewhat old way of categorizing countries. Industrialized countries such as the ones in Western Europe and North America are seen as the First World, and the Eastern bloc is (or was) seen as the Second World. All the nations that remain are considered to be Third World countries. The World Bank defines countries with less than \$ 7300 annual GNP per capita as Third World countries. They are further categorized into low-income, lower-middle and upper-middle-income economies. (Cavusgil & Ghauri 1990, 1-2)

For this research, the concept of Third World is far too unambiguous. It generalizes all countries that are not seen as industrialized economies under one category without taking much into account the level of their development. Hence, in this study the use of this term is avoided whenever possible.

### 2.3.2 *Least-developed countries (LDCs)*

The least-developed countries are at the lowest ladder of economic development. Their common characteristics are a low (less than \$ 3000) GDP per capita and underdeveloped manufacturing industries. The LDCs suffer from major weaknesses in infrastructure, e.g. transport and communications. Their public sector is usually slow and bureaucratic, thus presenting further challenges for private enterprises. These countries are commonly dependent on one product and, in the worst case scenario, only one trading partner. This dependency on one product (usually an agricultural product or a mineral) poses a heavy risk by changing patterns of supply and demand. As the international private investors are usually reluctant to invest without real prospects of significant economic development, the spending projects in LDCs commonly rely on world aid programmes. (Hollensen 2001, 145)

From the LDCs, Cambodia did best in the TDI survey and can be found from the 75<sup>th</sup> place. Sub-Saharan Africa is indisputably the most saddening region in the World in terms of economic development. In TDI-rankings, 17 (3 of which are however categorized as developing countries by UNCTAD) of the 18 weakest countries can be found from this area. TDI does not even give the whole picture, as the countries that are not even able to supply relevant data are obviously not evaluated at all in this research. The last countries of the ranking (e.g. Sudan and Nigeria) get exceptionally low scores in for example the infrastructure and economic structure indexes on the TDI. (Developing countries in... 2007)

One apparent reason for the low level of industrialization in Africa derives from the colonial era. The role of these countries as colonies was to supply primary commodities to their mother country. Many of these countries still, even if to a somewhat declining extent, rely on these commodities. Weak governance and frequent conflicts are typical for this region. And the future does not promise better for many of these countries either. Some of the poorest of the sub-Saharan countries (e.g. Guinea-Bissau and Togo) are in fact categorized by UNCTAD as “regressing” economies. (Johnson & Turner 2003, 75-77)

### 2.3.3 *Developing countries*

Sometimes no distinction is made between LDCs and developing countries, e.g. the International Monetary Fund (IMF) divides the world roughly into two major groups, advanced economies and others (Country Composition of WEO<sup>5</sup> Groups 2007). This

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<sup>5</sup> World Economic Outlook

more specific classification however makes a needed distinction between the usually stagnate LDCs that still rely on international aid and countries where economic development has already started to take pace, thus opening up more possibilities for the international actors.

According to the TDI, the group of developing countries consist mainly of South American (all excluding Mexico) and Asian (e.g. Indonesia and Philippines) nations. Most of the developing countries still need to improve their performance in at least human capital and institutional quality –indicators. This means that further investments are needed at least on education, health care and corruption control. (Developing countries in... 2007)

#### 2.3.4 *Newly industrialized economies (NIEs)*

Term *newly industrialized economies* (NIEs or NICs for *newly industrialized countries*) refers to former developing countries that have industrialized (and are still industrializing) rapidly (Vuoristo 2001, 75). For example, the International Monetary Fund uses this term. Hollensen summarizes this concept well:

*NICs are countries with an emerging industrial base: one that is capable of exporting. Examples of NICs are the “tigers” of south-east Asia: Hong Kong, Singapore, South Korea and Taiwan. Brazil and Mexico are examples of NICs from South America. In NICs, although the infrastructure shows considerable development, high growth in the economy results in difficulties with producing what is demanded by domestic and foreign customers. (Hollensen 2001, 145)*

As mentioned above, this concept also refers to e.g. the Southeast Asian “tigers”. These countries are however further ahead in their development process and have merely a fine difference compared to the developed countries. They are in fact sometimes categorized as developed countries (e.g. International Organizations and Groups). Two of these countries (Hong Kong and Taiwan are not evaluated because they are not seen to be independent nations by the UN), Singapore (5<sup>th</sup>) and South Korea (21<sup>st</sup>), also rank high on the TDI (Developing countries in... 2007). Hence it has to be considered when to treat them as developed countries rather than still emerging economies.

To make the classification of countries and their stage of development even more complex, also the term *rapidly developing economies* can sometimes be seen to be used when referring to emerging markets such as Malaysia and Chile (Emerging Markets). In

practice however, this can be seen merely as a synonym for NIE that is meant to emphasize the fast growth rate of economy.

### **2.3.5 *Developed countries***

Developed countries (excluding Singapore by UNCTAD classification) occupy the first 21 places of the TDI. The main countries in this group are European Union members (since 1995, i.e. EU15), North America, Japan, Australia and Israel. (Developing countries in... 2007)

These countries in general enjoy of a well-developed infrastructure. The developed economies have high per-capita income and electricity consumption. They also enjoy large-scale industrial diversification. Common disadvantageous characteristics include at least low economic and population growth rates. The importance of manufacturing industries is usually somewhat diminishing as service industries, notably transportation, finance and ITC, are constantly growing stronger. (Albaum, Strandskov & Duerr 2002, 89)

## **2.4 Emerging markets as perceived in this study**

The previous subchapters presented a jumble of terms, classifications and indicators related to economic development. Still one question remains somewhat unanswered: how to collectively define an emerging market?

As the term itself suggests, the growth rate of economy has to be high in order to be categorized as an emerging market. The simplest, even though not perhaps the best way, of evaluating this is the annual growth rate of GDP. In major emerging economies, this rate can be as high as 8-10% or even higher (e.g. Cateora & Ghauri 2000, 175). As the GDP is a rather one-sided indicator due to the fact that it does not take into account many aspects the marketers see as important issues (e.g. the level of education and infrastructure), other indicators (such as the TDI in this case) are needed to confirm that actual development is taking place and that the market is actually emerging.

In order to be a lucrative target market, a country has to be somewhat willing to accept international actors and investors instead of pursuing to drive them away with e.g. harsh tariffs and heavy bureaucracy. It has to be kept in mind however, that the emerging economies are, as mentioned in the chapter on NIEs, former developing countries. As such they may (and most likely do) still suffer from the old baggage of protectionism and corruption. The key issue is whether measures are taken to overcome these challenges or not. This is also noted in the TDI.

But as there are more than 130 developing and emerging countries in the world, not all of them can be as significant as some core countries from the world economy's point of view. The developing countries with the highest growth potential are called *Big Emerging Markets* (BEMs). To be considered as a BEM, a country has to:

- Have strong economic growth rate or at least potential for significant growth.
- Have undertaken major programmes of economic reform.
- Have a large population, be physically large and have political influence in its region.
- Represent considerable markets for wide range of products and be “regional economic driver”, thus serving as a gateway for further expansion to neighbouring markets as they grow.

At least the first two features can be seen as prerequisites for the determination of emerging markets in general. The other two (especially the third one) features rather determine how much influence a country has in the world economy. (Cateora & Ghauri 2000, 188)

In addition to the other country classifications mentioned, UNCTAD lists some emerging economies as one separate group (The Seven Emerging Economies), i.e. the E7: South Korea, China, Mexico, South Africa, Brazil, Russian Federation and India (Developing countries in... 2007). What should be noted is that all of these seven countries fulfil the requirements of a BEM listed above. Hence it could be concluded that these are the countries UNCTAD sees as the most important actors among the many emerging economies.

To somewhat summarize this description, there are some regions and countries that are usually mentioned when speaking of emerging markets. These include at least the newest (joined after year 1995) members of the European Union (most of them former communist countries), Latin America and the majority of Southeast Asia (e.g. Cateora & Ghauri 2000, 188-196).

It has to be pointed out that none of the four developmental stages presented earlier correlates perfectly with the concept of emerging markets. This concept is rather a combination of all the three upper stages, although the descriptions of NIEs and emerging markets seem to have the most similarities.

### 3 SMES AND INTERNATIONALIZATION

As already mentioned in the first chapter, the small and medium-sized enterprises are not identical. Actually the situation is quite the opposite: the vast group of SMEs include many different kinds of enterprises from the florist's shops in hospitals, hot dog –stands in city centres and other sole-proprietorships to largish industrial subcontractors and ITC-companies.

Still these smaller companies have many common characteristics and elements. These factors distinguish, guide and sometimes restrict the actions of SMEs. For this research, these characteristics are of vital importance, and will be introduced in this chapter. Obviously, these specific characteristics have an important role to play also in the internationalization of companies.

Internationalization as a process and the internationalization of SMEs in particular have been studied extensively. This chapter will present specific features of SME internationalization and especially the underlying challenges.

#### 3.1 General characteristics of SMEs

Before dwelling any deeper on the internationalization of SMEs, this sub-chapter will introduce some general characteristics of them. SMEs have common features that make them different compared to the *large-scale enterprises* (LSEs). These special characteristics include both advantageous and disadvantageous elements for the smaller companies.

Hollensen (2001, 7) has listed the most notable differences explicitly in his publication. Because this specific research aims not to compare SMEs and LSEs with each other, only the issues in focus, namely the characteristics of SMEs, are presented in the following table 1.

Table 1 Characteristics of SMEs (adapting Hollensen 2001, 7)

Resources	<ul style="list-style-type: none"> <li>• Limited resources</li> <li>• Outsourcing of resources</li> </ul>
Formation of strategy and decision –making process	<ul style="list-style-type: none"> <li>• Emergent strategy formation</li> <li>• The entrepreneurial decision-making model</li> <li>• The owner/manager is directly and personally involved and will dominate all decision making throughout the enterprise</li> </ul>
Organization	<ul style="list-style-type: none"> <li>• Informal</li> <li>• The owner/manager usually has the power/charisma to control the whole organization</li> </ul>
Risk taking	<ul style="list-style-type: none"> <li>• Sometimes risk taking, sometimes risk averse</li> <li>• Focus on short-term opportunities</li> </ul>
Flexibility	<ul style="list-style-type: none"> <li>• High</li> </ul>
Taking advantage of economies of scale/scope <sup>6</sup>	<ul style="list-style-type: none"> <li>• Only limited</li> </ul>
Use of information sources	<ul style="list-style-type: none"> <li>• Information gathering in an informal manner and an inexpensive way:</li> <li>• Internal sources</li> <li>• Face-to-face communication</li> </ul>

Only a few of the characteristics presented in table 1 can be unambiguously categorized as being a positive or negative feature. The only feature that can easily be seen as an advantage in this list is high flexibility, while limited resources (including taking advantage of economies of scale/scope) and limited access to information sources can be seen as sheer weaknesses.

The rest three of the characteristics, which describe the managerial and strategic decision-making skills and practises within a company, can be seen as more ambiguous. From different perspectives and in different situations, they can have either positive or negative effects.

Both advantages and disadvantages of SMEs and their effects on the internationalization process will be scrutinized more thoroughly later on in this chapter through SWOT-analysis.

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<sup>6</sup> Economies of scope represent the synergy effects of serving more international markets.

## 3.2 Inward internationalization

Internationalization can be categorized into *inward* (importing and sourcing) and *outward* (exporting) internationalization (e.g. Albaum et al., 13). As mentioned several times in this paper already, SMEs are quite active on the international markets. Perhaps due to this, the internationalization process of SMEs has gathered a lot of attention from researchers. But why does a given company want to initiate international business operations? This sub-chapter presents briefly the concept of inward internationalization and underlying motives. More information on outward internationalization can be found in subchapter 3.3.

### 3.2.1 A framework of internationalization motives

In a study of 55 Finnish manufacturing SMEs, more than two thirds began inward internationalization immediately after establishing their business, and only after this they carried out the internationalization with outward projects (Korhonen 1999, 186). In the light of this finding, the inward internationalization seems to be a less-challenging way to start doing international business for the SMEs, and serve as a gateway to international markets. Figure 1 combines a company's motives for internationalization of all natures. These motives are divided into four categories.

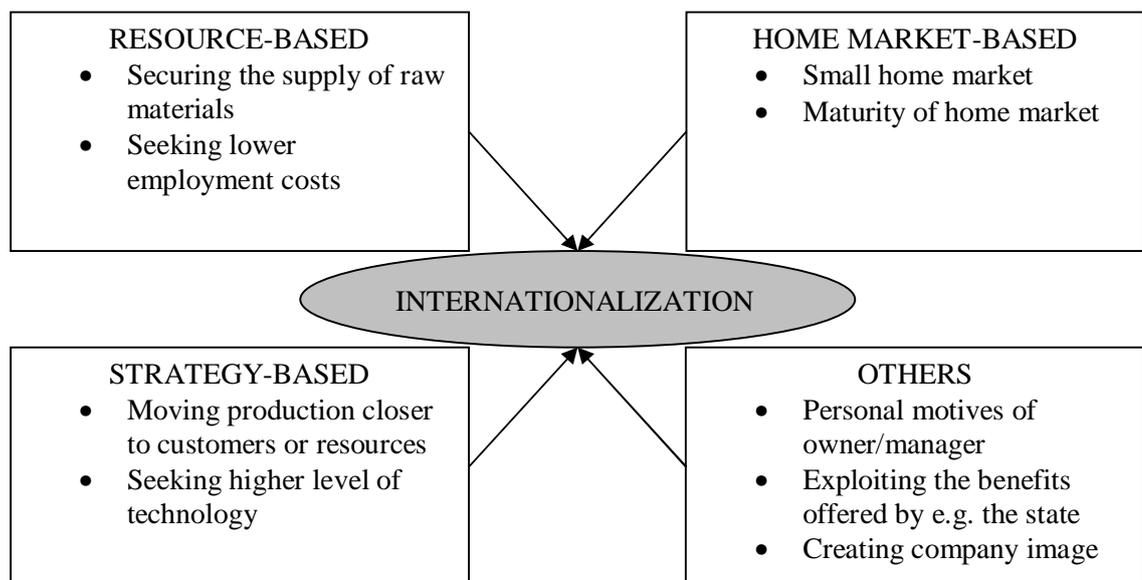


Figure 2 Motives for internationalization (Sutinen 1996, 14-19)

From the four categories presented, resource-based and strategy-based motives are clearly triggers for inward internationalization (sourcing), home market-based for outward internationalization and “others” may contribute to both forms of internationalization. The motives for inward internationalization will be presented in the following subchapter, based on figure 1. As for outward internationalization motives, a more extensive framework will be used.

### 3.2.2 *Motives for inward internationalization*

In some cases, a company is strategically dependent on a certain *raw material*, whose supply may be limited. In this kind of a situation, a company may want to acquire a partnership or even full ownership of the source of this raw material. Good examples of this sort of crucial raw material are certain metals and crude oil. However, this is a rare reason for SMEs to internationalize. Still, there are exceptions. For example the Finnish stove manufacturer Tulikivi Oy acquired a deposit of rare stone from USA in the 1990’s in order to secure their supply of this raw material essential for their production. (Sutinen 1996, 14)

A rather common motive for internationalization, seeking *lower employment costs* requires little introduction. The so-called China-phenomenon has gathered a lot of attention as companies are moving their production to countries with lower costs of labour and longer working hours in order to keep up with the competition. The direction of this internationalization is almost without exception inward, and manufacturing functions tend to get globally sourced. In some industries, the high employment costs in industrialized countries have led to a situation where close to none realistic possibilities for keeping domestic production functions running exist. (Sutinen 1996, 14)

Both Sutinen (1996, 15) and Hollensen (2001, 311) use the textile industry as an example of an active user of international sourcing. Hollensen (ibid.) points out that in the manufacturing of clothes, 80% of the labour costs are generated in the sewing stage, and thus companies have eagerly moved this production to countries with lower employment costs in e.g. Eastern Europe and Far East. Sutinen (ibid.) suggests that the target countries are changing from the countries that were popular in the 1990’s, such as China and Thailand, to their so far less-developed neighbours like Vietnam, Bangladesh and Laos.

This internationalization due to seeking lower employment is rather relevant when it comes to business operations on emerging markets. All the example countries mentioned in the preceding paragraph can be categorized as emerging economies. Even if their economy is growing at a high rate, wages in these countries are still far from the income levels of the developed countries.

It has to be pointed out however that for some reason, the Finnish SMEs have not been as active in establishing production facilities of their own abroad as their, for example, German and Swedish counterparts. This is probably due to the weaker financial position of Finnish companies, as they lack the rather large amount of capital needed for these kinds of projects. The Finnish actors tend to rather turn to subcontractors when formulating sourcing strategies. (Sutinen 1996, 15)

As the level of infrastructure in emerging economies is usually lower than in the developed countries, seeking *higher level of technology* is usually not a relevant motive for internationalization for this research. This can however open possibilities for exporting companies in developed economies as the enterprises from emerging economies may wish to seek partners with higher technological capabilities.

### **3.3 Outward internationalization (exporting)**

As this study concentrates mainly on export operations, inward internationalization was only presented briefly in the previous subchapters. This following subchapter concentrates on a topic more relevant for this research: outward internationalization, i.e. exporting. After scrutinizing the motives behind initiating export operations, the most common export modes will be presented.

#### **3.3.1 *Export motives***

The motives for internationalization presented earlier in chapter 3.2.1 clarify the reasons behind internationalization in general. As this study concentrates on outward internationalization, the following table 2 gives a more detailed picture of companies' export motives.

Table 2 Export motives (adapting Albaum et al. 2002, 48)

	INTERNAL	EXTERNAL
PROACTIVE	<ul style="list-style-type: none"> <li>• Managerial urge</li> <li>• Marketing advantages</li> <li>• Economies of scale</li> <li>• Unique product or technology competence</li> </ul>	<ul style="list-style-type: none"> <li>• Foreign market opportunities</li> <li>• Change agents</li> <li>• Tax benefits<sup>7</sup></li> </ul>
REACTIVE	<ul style="list-style-type: none"> <li>• Risk diversification</li> <li>• Extend sales of seasonal products</li> <li>• Excess capacity of resources</li> </ul>	<ul style="list-style-type: none"> <li>• Unsolicited orders</li> <li>• Small home market</li> <li>• Stagnant or declining home market</li> </ul>

These export motives are divided into *proactive* and *reactive* motives based on whether they are a strategic decision aimed to improve the position of the company or merely a countermeasure to changing conditions in the company's environment. The motives are further divided into *internal* and *external* motives. In a nutshell, internal motives derive from the company itself as external motives are a consequence of pull or push –effects deriving from the surrounding world, e.g. government or change in market conditions. Obviously, reactive external motives can not be seen as the best reason to initiate internationalization as the company seems to be merely struggling against the forces surrounding it.

### 3.3.1.1 Proactive internal motives

*Marketing advantages* may be understood in a couple of ways. Albaum et al. (2002, 50-51) mainly refer to better market information and strong marketing activities, i.e. an efficient marketing infrastructure, strong sales force etc. Then again e.g. Stevens and Sherwood (1987, 43) refer to a situation where one company has a more positive image as another in the minds of customers. The SMEs tend not to be masters of information gathering, and usually have lighter marketing infrastructure than large companies. Hence, this is probably not a common motive for SME internationalization. However, being nameless on a foreign market may in some cases be an advantage, mainly in a situation where large companies have for some reason a bad reputation in a certain region. For example, the Finnish fast food chain Hesburger opened in 2004 a restaurant

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<sup>7</sup> Hollensen 2001, 29

in Syria, where American products, including e.g. Hesburger's direct competitor McDonalds, are practically banned (Negus 2005). Although this mentioned restaurant in Damascus was closed later on due to business being unprofitable, this is a good example of how a smaller company with little reputation is able to do business in a country that is unreachable for its larger rivals.

Through exporting fixed costs, arising from e.g. administration and R&D, can be spread over more business units (e.g. Albaum et al. 2002, 50). Although the SMEs tend to have limited possibilities to exploit these *economies of scale*, this opportunity should not be despised even by smaller companies. However, on markets where economies of scale are strong. SMEs should usually concentrate on niche marketing (Hall 1995, 11).

If a company has developed a *unique product or technology* in its domestic markets, it is more likely to be successful on foreign markets as well, and especially if this capability has required significant use of resources in developing, the economies of scale achieved through exporting can relieve the effect of the sunk costs to the company (Albaum et al. 2002, 49). Hodgetts and Kuratko (1992, 18) actually see that technical competence is the most important characteristic for an SME to be successful on any given market.

In many cases, a single person or a small group of persons is responsible for exporting decisions in SMEs. It has been noted that individual characteristics correlate strongly with export behaviour. If the decision-maker of an SME e.g. has international experience from previous employments, or has lived or worked abroad, it is more likely for the company to have *managerial urge* to internationalize. In this case, the formation of foreign market entry strategy is dependent on the decision-maker's personal perceptions of foreign markets (Albaum et al. 2002, 48-49)

### **3.3.1.2 Proactive external motives**

National governments, authorities and other organizations (more of these in chapter 4) usually aim to support both inward and outward internationalization of companies. Sometimes the assistance and subsidies offered by these *change agents* may seem so lucrative for a company that they become a motivator rather than an enabler of internationalization. (Albaum et al. 2002, 50)

The assistance from government mentioned in the previous paragraph may include offered *tax benefits*. A company may use these tax benefits either to offer products at a lower price or to accumulate higher profit. Thus, these benefits can play a major motivating role in internationalization. (Hollensen 2001, 32)

Sometimes companies even attempt to avoid taxes, or at least lower them significantly by channelling their business through so called tax havens i.e. countries

with low or nonexistent tax rates for foreign companies. This is however usually pointless as national governments are quite aware of this possibility and have imposed regulations to avoid the loss of revenues to the tax havens. (Woods 2001, 153)

A company should not enter a foreign market unless the target market has to offer a possibility to do profitable business. As this is such an important theme in this research, pursue of benefiting from *foreign market opportunities* will be scrutinized more thoroughly in the forthcoming chapters.

### **3.3.1.3 Reactive internal motives**

If a company is active in only one market area, it is likely to be highly affected by the fluctuations of that area's economy. This means that if recession hits this market area, the company's business is likely to suffer from this. A company may aim to decrease the ill effects of such regional recessions by *risk diversification*. The underlying motive for this is the assumption that if sales decrease on domestic market due to regression, foreign market sales may remain unaffected, thus compensating the losses from home market. (Albaum et al 2002, 49-50)

Demand of certain special products, e.g. clothing and sports equipment, may suffer from strong seasonal fluctuation as for example few people are willing to buy skis in the middle of summer. A company may wish to *extend sales of seasonal products* by expanding its operations into different hemispheres where the season for their products is at a different time of the year as it is on their domestic market. (Albaum et al. 2002, 51)

Having *excess capacity of resources* means that a company can produce, or is producing, more than it can sell on the domestic market. If the company does not wish to cut down its production, it can attempt to find demand for its products from the foreign market. Selling the surplus products abroad at a lower price than on domestic market is called dumping, which for example the EU is attempting to prevent by imposing antidumping tariffs. (Albaum et al. 2002, 51)

### **3.3.1.4 Reactive external motives**

Sometimes a company that is not actively aiming to internationalize, i.e. is not trying to find foreign partners or customers by marketing overseas for example, may anyhow receive *unsolicited orders* or enquiries from foreign actors that have for some reason become aware of the company. These enquiries can result from e.g. exhibitions or word of mouth. An interesting finding is that in different countries, the majority of exporting

companies initiated their export operations after receiving unsolicited orders. Obviously, even if unsolicited orders are received, a company must still fulfil the basic requirements for international operations in order to start exporting. (Albaum et al. 2002, 52)

A company may also be more or less forced into exporting by domestic market conditions. If a company has a *small domestic market* for its products, it may not have any alternative but to search for international customers. This type of situation is common with highly specialized industrial products that may in some cases only have a few potential customers worldwide. (Albaum et al. 2002, 52-53)

Foreign market entry may also be a means to amend the declining revenues from *stagnant or declining home market* as in a situation where the domestic market is highly saturated, there may not be much a company can do to increase sales there (Albaum et al. 2002, 53). This motive is very relevant for this study, as the markets in developed countries tend to be saturated and highly competed.

### 3.3.2 *Export modes*

Before composing the SWOT-framework for SME internationalization, a brief look should be taken into the various exporting activities available for a company. These most common export modes are presented in the following figure 3.

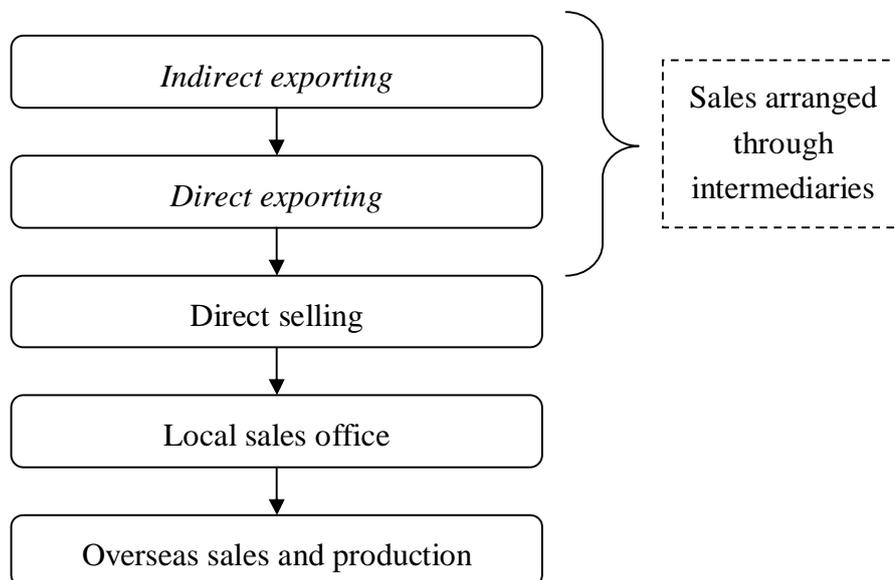


Figure 3 Export modes (adapting Lynch 1992, 131)

As the term suggests, *indirect exporting* does not require any international contacts, but the sales are arranged through a domestic intermediary. Usually this intermediary is an agent or a distributor. This activity causes little if any additional costs or risk to the

exporting company. This is not however an efficient way to internationalize business as the learning experience from international markets is highly limited, due to the fact that information on target markets and customers is only gathered through (sometimes several) intermediaries. (Ahokangas & Pihkala 2002, 30-32)

In *direct exporting*, a company uses a foreign intermediary. This mode is otherwise similar to indirect exporting, but in order to be able to do business abroad a company usually needs people with language proficiency and understanding of export protocols. Probably the biggest challenge in direct exporting is finding the right, i.e. reliable and efficient, intermediary abroad. (Ahokangas & Pihkala 2002, 32-33)

If a company wishes to drop intermediaries out of the equation, it may initiate *direct selling* by marketing and delivering the product directly to the buyer or end-customer (Ahokangas & Pihkala 2002, 32-33). This is the first of the export modes where the exporting company is in direct contact with the customer, thus offering the opportunity for gathering direct feedback from the customers and e.g. carrying out marketing research. The operation is however still managed from the company's home country.

If a company wishes to have permanent representation in the host country, it may establish a *local sales office* or subsidiary thus transferring the actual sales function to the foreign market. Usually core functions (e.g. marketing) are managed mainly from the home country, but the company may decide depending on the situation how much autonomy and responsibility is granted for the subsidiary. The benefit of these subsidiaries is undoubtedly getting the company's own people as close to the customers as possible. Sales subsidiaries may also at some situations offer tax advantages for the company. (Hollensen 2001, 294-295)

However, especially in the developing countries sales subsidiaries may be perceived by the local people as if the company is only taking money out of the country without really contributing to the local economy. Giving this impression may be avoided by initiating *overseas sales and production*. This can be done by establishing or acquiring a subsidiary. This can be considered as the ultimate stage of internationalization, as everything (with the exception of strategic management perhaps) from production to selling and delivery is arranged by the foreign subsidiary. Motives that may bring this alternative under consideration include at least:

- Defending existing business from or to avoid government restrictions.
- Gaining new business through showing commitment to the host country.
- To save costs (e.g. transport, labour and raw materials).

This export mode requires high investments and commitment from the company; hence the risk involved is extremely high. E.g. withdrawal from a chosen market can be very costly, and not only in the financial way but in terms of reputation as well. (Hollensen 2001, 295-296)

It has to be kept in mind however that these five export modes presented above are indicative in nature and merely present the basic, generalized forms of export operations. International operations are not necessarily this ambiguous, and especially different kinds of forms of cooperation with other companies offer vast possibilities to do international business. These alternative export modes include for example licensing, franchising and joint ventures with other exporting companies as well as e.g. hiring sales representatives (both domestic and foreign). (E.g. Hollensen 2001)

It is no surprise that researchers and consultants have aimed to develop tools to assist smaller companies in the choice of foreign market entry modes. E.g. Reinhold Decker and Xuemin Zhao have developed a mathematical decision-making model for SMEs. However, even the researchers are forced to admit that due to the complexity of the issue, this model can be considered to be normative at the best. (Decker & Zhao 2003, 197)

### **3.4 SWOT-analysis of SME internationalization**

In this sub-chapter, first a SWOT-analysis of SME internationalization will be presented. After this, the strengths and weaknesses, along with opportunities and threats of an internationalizing SME will be scrutinized.

#### **3.4.1 *SWOT-framework***

Empirical findings suggest that the internationalization of SMEs is very time-consuming, and it should happen in a well-planned manner. In addition, differences between the internationalization of so-called conventional SMEs and their more innovative counterparts can be noticed. (Johnson & Turner 2003, 128)

Therefore, the question lies in what forces affect the internationalization process. In order to better comprehend these factors, an analysis of the strengths, weaknesses, opportunities and threats of internationalizing SMEs is conducted. This SWOT-framework is presented in figure 2.

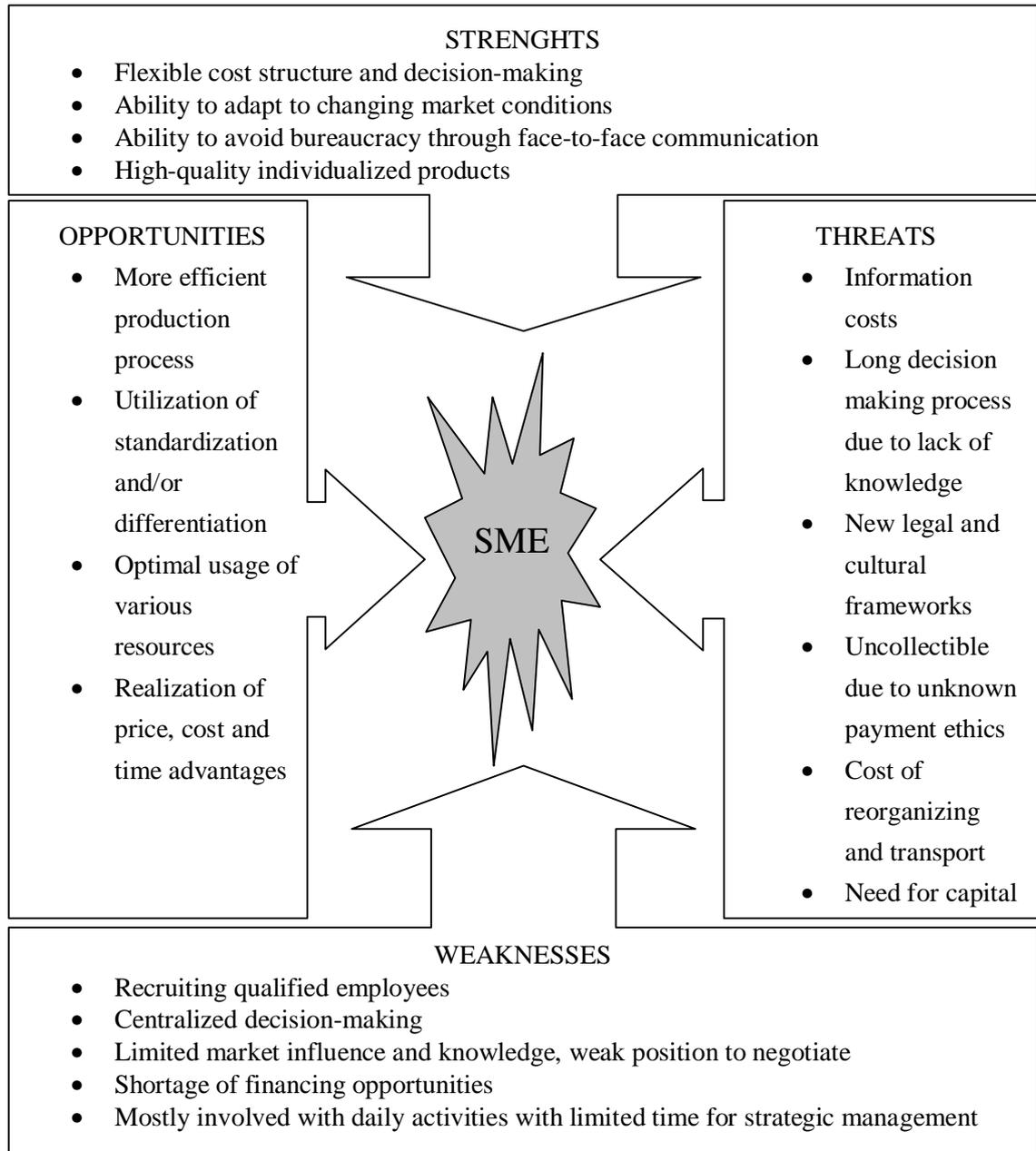


Figure 4 SWOT analysis of SME internationalization (adapting Johnson & Turner 2003, 132)

This SWOT-framework gives an extensive view of the issues affecting SME internationalization. If this framework is compared to table 1, which presented general characteristics of SMEs, many similarities can be noticed. These similarities will be pointed out more clearly in the forthcoming subchapters, as the SWOT-framework is scrutinized more thoroughly.

### 3.4.2 *Strengths*

One of the key advantages the SMEs undisputedly possess is their remarkable *flexibility* mainly made possible by their lighter organizational structure. Hollensen (2001, 11) argues that when necessary, the SMEs can respond quickly to customer enquiries mainly due to the shorter communication lines between the company and their customer.

A study was carried out in the early 1990's that investigated the activities and exporting operations of 160 Danish SMEs that exported more than 5% of their total output. One of the studied features was the ability and willingness of SMEs to *adapt to changing market conditions*. From the sample, 82% of the companies reported having changed their process technology and/or production in order to respond to changes in foreign market conditions. Moreover, 27% of all respondents reported this change to be "very high" or "complete". From this sample however, only 6% of the micro enterprises (in this study referring to companies with 15 employees or less) reported high or complete change in production. According to this research, SMEs are in this respect flexible, but the larger SMEs seem to be more flexible than the smaller ones. (Hansen, Gillespie & Gencturk 1994, 16-18)

The high levels of flexibility and adaptation of production undoubtedly lead to the possibility to offer highly *individualized products*. It still remains unclear however why should SMEs have higher quality standards than LSEs as Johnson and Turner (2003, 132) suggest. Also Pleitner, Brunner and Habersaat (1994, 50) mention this feature as a strength of SMEs. Neither of these teams however explains this view. Perhaps these scholars believe that quality control is easier when production quantities and the amount of workers are smaller?

Entrepreneurs usually aim to create personal contact networks since they are more comfortable doing business with people they are acquainted with, and usually these kinds of networks are strong in both buying and selling (Carson et al. 1995, 278). Johnson and Turner (2003, 132) see that it is also possible for the SMEs to *avoid bureaucracy through face-to-face communication*.

### 3.4.3 *Weaknesses*

Ghauri, Lutz and Tesform have studied the export-marketing problems of SMEs from developing countries. Their emphasis was on using networks to overcome these challenges. They are convinced that although these problems are sometimes perceived as being country-specific, there are similarities among SMEs from different regions, thus making their research also applicable here. (Ghauri et al. 2003, 729)

The export-marketing problems of SMEs can be categorized as *internal* and *external problems*. Internal problems are often linked to insufficient organizational resources. External problems are challenges the company has no means of remedying itself. These include for example the differences between market systems, national policies and exchange rates. (Ghauri et al. 2003, adapting e.g. Lall, 1991)

The relevance of this classification could be questioned however. The market systems and exchange rates are theoretically the same for every company. If the problem arises due to e.g. lack of employees who understand and are capable of overcoming these obstacles, does this not make this again an issue of resources?

This above-mentioned ability to *recruit qualified employees* is often one of the stumbling stones of the SMEs. The smaller companies can seldom compete on salaries with the ones large corporations have to offer. Problems especially arise when hiring managerial personnel. In many cases the SMEs are first established and run by people with experience mainly in production and general management. In time, when the business grows larger, more (outside) expertise is needed in e.g. finance and marketing. As the salaries tend not to be very competitive, already qualified people are often hard to be found. Furthermore the owners are sometimes reluctant to develop their managers as they fear that skilled managers leave the company and set up in competition. (Carson et al 1995, 64)

If the company lacks managers, i.e. it is up to only few persons to run the company's business; it may lead to a situation where the managers are *mostly involved with daily activities with limited time for strategic management*. As most of the researchers that have studied internationalization emphasize the meaning of strategic planning, this can prove to be a large obstacle on the way to international markets.

Furthermore, if the managerial structure of a company is thin, the *decision-making may be highly centralized*. Especially if the company is managed mainly by only one or few owner-managers, the decisions concerning e.g. marketing strategies tend to be highly intuitive and often reflect the implicit vision of the world of this person or persons rather than being based on carefully gathered market information and planning (Carson et al. 1995, 89-90).

SMEs initiating export operations tend to suffer from *shortage of financing opportunities*. Although there are institutions (these will be presented later on) that give financial support to SMEs in various stages of their lifecycle, especially getting private investors interested can be troublesome. Johnson and Turner (2003, 132) see that this derives simply from the fact that smaller companies are a bigger risk for investors.

One challenge facing companies in general already from the first steps of the internalization process is getting enough and right kind of quality information. It is easy for a company's management to jump into hasty conclusions when they have inadequate information of the market area they wish to operate in. The right kind of

information can surely be found or gathered, but at what cost is completely another issue. (Sutinen 1996, 66)

E.g. Cateora and Ghauri (2000, 145-165) have come up with an extensive framework for gathering foreign market information and encourage exporters to use primary data for market analysis whenever possible. Carrying out market research of this scale requires a great deal of time and resources however, and at least the latter is a luxury only a few SMEs possess. Thus SMEs usually have to manage with *limited market knowledge*, and have to make their exporting decisions based on limited amount of target market information. Luckily secondary data is in many cases available from international organizations, chambers of commerce and other trade organizations (Cateora & Ghauri 2000, 167). Still in many cases, the information SMEs gather is mostly incomplete and fragmented, and decisions are based on intuition or even pure guess (Hollensen 2001, 12).

If a small company does not have a unique product or know-how to offer, thus increasing its influence over those needing this capability, it probably has *limited market influence* compared to its larger competitors. And if a company lacks ways to put pressure on the other actors on the market, it is undoubtedly in a rather *weak position to negotiate*.

#### 3.4.4 Opportunities

Sutinen (1996, 126) sees little possibilities for Finnish exporting SMEs to aspire cost leadership as e.g. the labour costs in Finland are so high. However, this statement is only applicable if the production takes place in Finland. And obviously labour costs are not the only cost factor of production. Hollensen (2001, 311), while writing about industrial subcontractors, reminds that in order to be cost efficient, the total costs towards the end customer have to be minimized. This means that a *more efficient production process* requires measures to be taken in every step of the way, from purchasing raw material to production and finally delivering the finished product to the customer. As the SMEs usually have to manage with scarce resources, it is crucial for them to achieve an *optimal usage of various resources*. In addition, Hollensen (2001, 312) points out that uncertainties in especially delivery times have a remarkable impact on industrial buyer's performance, but can be significantly reduced by close cooperation between the buyer and seller. This is the SMEs' opportunity to excel. Their high flexibility makes it possible for them to adapt their activities swiftly according to the buyer's wishes, and the short chain of command makes it easier to stay in close contact with the customer.

To get the most efficiency out of its resources, a company must possess some analytical skills. The *realization of price, cost and time advantages* require wide understanding of market and customer characteristics, along with being in control of the production chain. Once again, the flexibility and low level of bureaucracy in SMEs should enable taking advantage of these possibilities.

Before starting exporting, a company has to decide its product portfolio and -strategy for foreign markets. By *standardizing* products, the production process can be made more cost efficient. It decreases the costs derived from for example R&D and storing, and generates economies of scale. But in exporting, standardization is not always even a possible strategy. E.g. technological and geographic characteristics may hinder or prevent the use of products initially designed to be used in another market area. (Sutinen 1996, 128-133)

*Differentiation* can be carried out in various ways. A company may add or remove elements of the core product, or offer differentiated service to different customers. It is even possible to use marketing for differentiation by creating different images. Obviously this strategy requires more resources from the company than selling standardized products to all market areas. If the company lacks these required resources when planning to launch its product onto new market, it practically has only two options: either to postpone the launch or to launch the product as it is. (Sutinen 1996, 127-134)

As mentioned earlier, SMEs have limited autonomy in their actions, due to their size and resources. Hence, according to Ghauri et al. (2003), it is typical for the smaller companies to try to increase their capabilities to operate and decrease their risks by vertical and horizontal networking. Obviously companies of all sizes can form networks and alliances, but nonetheless this could be mentioned as an opportunity especially for the smaller companies with fewer resources.

### **3.4.5 Threats**

There is usually more information available of the developed countries than the developing economies, and it could be said that more exotic and less-developed a country, the higher the *costs of information* tend to be (Sutinen 1996, 67). An SME with limited resources can not afford to make many missteps, as an unnecessarily (eventually export operation is initiated to the researched market) carried out extensive market research can in worst case exhaust the funds reserved for information gathering. Still the costs of unnecessary research are likely to be lower than those deriving from failed export operations.

Hollensen (2001, 627) is convinced that most SMEs conduct no international market research before expanding onto foreign markets, even though carrying out research on domestic markets would be obvious for them. Johnson and Turner (2003) do not specify what they mean by listing *long decision-making due to lack of knowledge* as one of the threats of SME internationalization. It could be assumed however that lacking proper information may lead to a situation where company's management postpones the exporting decisions further and further, and finally the once open opportunity on the foreign market is lost.

The characteristics of foreign markets, especially developing ones, may differ remarkably from the company's domestic market. The culture, legislation and business customs may be completely different than those the company is familiar with. If the exporting company has not proper market knowledge, the *new legal and cultural frameworks* on the foreign market may be difficult to handle. As Johnson and Turner (2003, 132) remind, a harsh way of realizing the difference in business culture is if the exporting company faces *uncollectible due to unknown payment ethics*.

There are *reorganizing costs* deriving from starting export operations. These are usually non-recurrent expenses that may include marketing, expert's fees and travels to potential customers. If the company lacks funds and financial support, it might be challenging to take care of these expenses. (Sutinen 1996, 83-84)

Also *transportation costs* have a higher meaning in exports than in domestic trade. Usually transportation constitutes 10-15 per cent of the costs of imported goods. Depending on e.g. which of the four main modes of transport (road, water, air and rail) is used and the nature of the product, the cost of transportation varies significantly. However, the exporter should keep in mind that especially when exporting to developing countries, all of the mentioned transport modes may not be available and furthermore, the infrastructure may be poor in the developing economies. (Hollensen 2001, 496-497)

The funding for exporting can be arranged through equities, liabilities or subsidies. Usually the managers of SMEs are well aware of these possibilities. Still the *need for capital* in initiating and carrying out export operations can surprise the management of an SME. There are two basic underlying reasons for this: firstly the rapid increase of the amount of needed capital and secondly the possible exhaustion of existing financiers. (Sutinen 1996, 83)

In this subchapter, common threats associated with export operations were presented. To reduce these risk factors, a number of national and international organizations offer professional and financial assistance for enterprises. Many of these organizations offer support especially to smaller companies in order to encourage their growth and internationalization. Some of the organizations supporting Finnish SMEs are briefly presented in the following subchapter.

### 3.5 Organizations supporting the internationalization of SMEs

To be considered legally as an SME offers some advantages to a company. It can for example be entitled to special subsidies and funding from public organizations. In this sub-chapter, three public organizations, Finpro, Finnvera and TEKES are introduced briefly. These organizations offer services to support the development and internationalization of companies, especially SMEs. Here they are merely used as examples; an internationalizing company can also find support and information elsewhere.

*Finnvera* was established in 1999. It is the official Export Credit agency of Finland, and is fully state-owned. Law defines its three main goals: developing and financing SMEs, promoting their internationalization and promoting national goals of regional policy. (Larjovuori, Laiho, Talonen & Järvelin 2003, 33)

Finnvera offers loans for the internationalization of SMEs. This loan can be used for establishing or developing of a foreign subsidiary. For the same purposes, Finnvera also offers securities. (Pk-yrityksen kansainvälistymisen ratkaisut)

*Finpro* is an association of over 500 Finnish companies, the Confederation of Finnish Industry and Employers and the Finnish Entrepreneurs Organization. Its organization comprises of Market Information Centre, Innovation Centre and 52 Finland Trade Centres in 40 countries. In addition, Finpro offers marketing services to companies through its subsidiary, Finpro Marketing Ltd (Larjovuori et al 2003, 29-31)

However, the main service Finpro offers is organizing of export-rings. These rings are joint projects of 4-6 companies, to whom Finpro offers an expert to assist with exporting-related problems. The main benefits for the participating companies consist of e.g. dividing the costs of using an experienced consultant between the partners and sharing of information. (Vientirenkaat)

This interacting in a business network is not as explicit as one might think. Research can construct tools for managers to help them understand the structure of networks and relationships, but no theory is able to make strategic decisions for the managers. A relationship of this kind offers many opportunities and threats. Creating a network can be costly for a company, and trying to move away from an existing network can incur more expense. On the other hand, it may offer possibilities that would otherwise be out of reach for the company, usually due to the lack of resources. (Håkansson & Ford 2002, 138)

*Tekes* (the Finnish Funding Agency for Technology and Innovation) is a public financing and expert organisation who promotes research and technological development in Finland. Tekes finances industrial R&D projects as well as projects in e.g. universities. Its primary objective is to promote the competitiveness of Finnish industry and service sector by assisting in the creation of technology and know-how.

Tekes encourages small companies to initiate research and development projects by offering them combinations of subsidies and loans. It funds some 2000 projects annually. (Tekes in a Nutshell)

However, it has to be pointed out that Tekes is not specialized in the internationalization of companies, but is more concerned of the development of technology itself. Still it can be a valuable source of funding for small companies especially in technology-intensive industries.

Other possible sources of assistance and mainly information include for example domestic and foreign chambers of commerce, consults, statistics centres and various foreign trade organizations. There are also various possible sources of funding, ranging from governmental organizations to investment trusts. (Sutinen 1996, 76-107)

## **4 EMERGING MARKETS AS A TARGET MARKET FOR SME INTERNATIONALIZATION**

Chapter 2 aimed to clarify the concept of emerging markets. Chapter 3 presented the internationalization process from SMEs' point of view. This chapter aims to unite these theoretical frameworks in order to study the internationalization of SMEs on emerging markets.

First, keeping in mind that the objective of this research is to scrutinize the operations of SMEs especially on emerging markets, a framework of a company's target market selection will be briefly introduced.

Then, common opportunities and challenges for business on emerging markets will be presented. But rather than dwelling into country-specific characteristics and differences, this study concentrates mainly on finding similarities among the somewhat diverse group of emerging markets.

### **4.1 Target market selection**

Internationalization, as well as strategic operations in general, should take place in a well-planned and well-coordinated manner. E.g. Hodgetts and Kuratko (1992, 34-35) name lack of customer information and lack of marketing research as examples of the eighteen "management traps" which are common causes for small business failure. The following figure 5 presents a framework of company's international market selection (IMS).

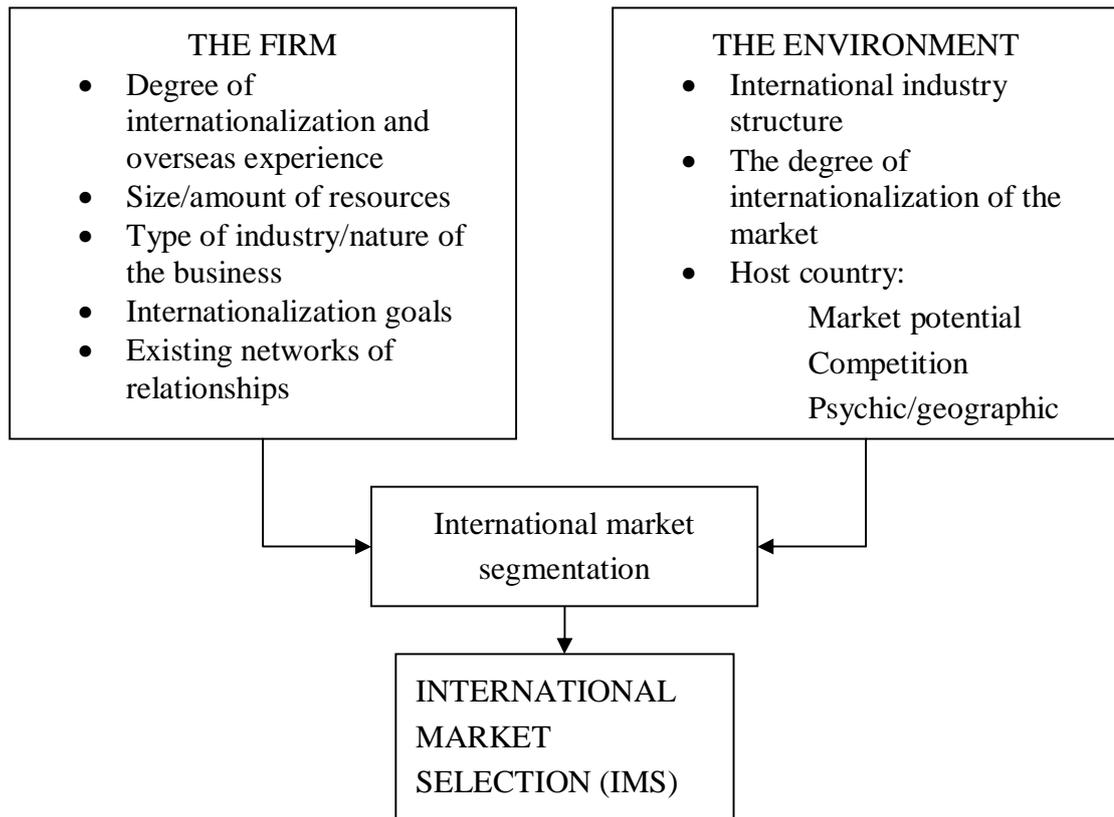


Figure 5 Potential determinants of the firm's choice of foreign markets (Hollensen 2001, 189)

The IMS could be seen to result from a situation where a company's capabilities and desires meet with the possibilities and characteristics of a potential foreign market. Figure 5 presents how these characteristics can be evaluated by a few major determinants. These underlying determinants are studied more closely in the following two subchapters.

#### 4.1.1 *Company characteristics*

An important factor affecting not only the company's choice of target market, but entry and expansion strategies as well is the *degree of internationalization* of the company. Figure 6 presents one possible strategy for entering emerging markets to companies from industrialized countries.

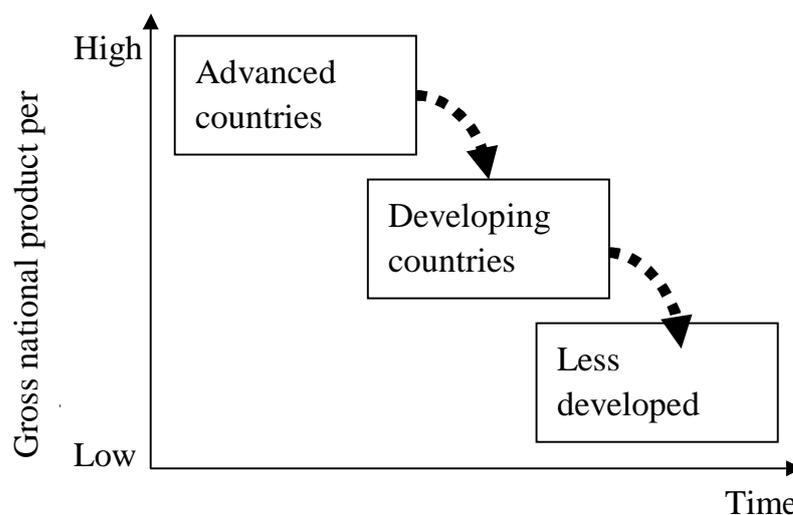


Figure 6 The waterfall approach (Keegan 1995<sup>8</sup>)

In the waterfall approach presented above, a company first gathers experience from the developed markets before entering the usually more challenging emerging markets. The opposite strategy for the waterfall approach is the shower approach, where several foreign markets with different levels of economic development are entered simultaneously. However, for the SMEs with fewer resources and especially those with less experience of the foreign markets in general, the presented waterfall approach is probably more suitable. (Hollensen 2001, 204-205)

It has to be mentioned however that it is not always easy to assess the degree of internationalization of a company. Usually this is done by using quantitative methods, e.g. number of foreign markets the company has operations on or the percentage of foreign sales from turnover etc. Qualitative indicators such as management's international orientation or the used export modes may seem lucrative, but are often extremely difficult to evaluate. (Albaum et al. 2002, 57)

Another important factor, already mentioned incidentally in the preceding paragraphs, is the amount and nature of *overseas experience* gathered by the employees of the company. This experience can be either market-specific or experience from international operations in general. This experience has a significant role in reducing the costs and uncertainty of serving a foreign market. According to studies, international experience also seems to encourage committing resources to internationalization and export operations. (Hollensen 2001, 237)

Two factors, namely *size of the company* and *amount of resources* are often entwined. As entering emerging markets tends to demand more resources from the

<sup>8</sup> According to Hollensen 2001, 204

exporting company, the developing potential target markets may face the threat to be dropped from the IMS already in the planning stage.

The *type of industry* a company operates in affects the internationalization in two phases. First, some industries are more export-oriented than others are, and it is more likely for a company operating in an export-oriented industry to initiate internationalization. This way of thinking is based on the SCP (Structure Conduct Performance) –paradigm from the 1950's, whereby the structure of an industry defines the strategies of the companies in that industry (Ahokangas & Pihkala 2002, 19).

Secondly, the type of industry affects the IMS as some products are, as mentioned earlier, simply not in demand on some markets due to e.g. geographic characteristics. The lucrativeness of a given target market may also vary depending on the *nature of business* the company does, i.e. whether it has the role of a buyer or a seller, retailer or an industrial subcontractor etc.

The motives for internationalization were presented in chapter 3. These motives for starting export operations virtually dictate the *internationalization goals* of a company. These goals vary from fulfilling the manager's dreams and exploiting subsidies to making higher profit and benefiting from economies of scale.

A specific market area or country probably seems as a more lucrative target for initiating exports if the company already has *existing networks of relationships* present. As it was mentioned earlier in this subchapter, previous experience from international business affects the export operations of a given enterprise. From this point of view, existing networks (both business and personal) could be seen merely as a consequence of this past experience.

#### **4.1.2 Target market characteristics**

The business population of a country depict its *international industry structure*. This concept is bisected, on the other hand it refers to the willingness of the host country business people to do international co-operation and trade, but more importantly it refers to e.g. the characteristics (size, strategy etc.) of the host country enterprises. Whether some qualities are positive or negative from this point of view is almost entirely dependent on the exporting company's goals of internationalization. (Hollensen 2001, 192)

The *degree of internationalization of the market* has to be assessed. Whether there are several or none multinational companies on the target market can have a significant effect on how challenging a given market is to enter. Also the attitude of local officials towards international actors can vary. Hollensen (2001, 238-239) mentions a couple of issues related to this characteristic, i.e. country risk and trade barriers that have to be

taken into account when deciding which markets to enter and which export mode will be used. The degree of internationalization can somewhat be seen to be linked to the level of economic development.

There are two major determinants for evaluating the host country *market potential*: firstly the number of possible buyers (or users) of a product and secondly the expected purchase rate. There are mathematical models for assessing the potential of a market, but they demand wide market research in order to give reliable information. Nonetheless, market potential is obviously a useful way to assess the attractiveness of a market and at least some level of research on market potential should be done before entering a new foreign market. (Albaum et al. 2002, 212,214)

Intense *competition* in a potential host market makes internationalizing companies less willing to make heavy resource commitments on this market. This is due to the fact that highly competed markets tend to be less profitable. Therefore, if export operations are initiated on these kinds of markets, companies will most probably favour export modes that require less commitment and allocated resources from them. (Hollensen 2001, 239)

The *geographic distance* to host country affects mainly logistics and can in some cases present challenges in inter-company communication (different time zones, visitations are expensive etc.). Sutinen (1996, 119) sees that if a company decides to initiate operations in distant markets, the selected target market should be large in order to achieve better returns for the allocated resources.

The *psychic distance* between home and host countries is assessed by the countries' sociocultural characteristics. Socioculturally similar countries have e.g. a common or similar language, similar business practices and comparable cultural characteristics. A broad psychic distance between home and host countries can create internal uncertainty for the exporting firm and tends to make the market less lucrative for export operations, especially if they would demand a large-scale allocation of the company's resources. (Hollensen 2001, 238)

The host country *market similarity* with home country market refers mainly to market behaviour, i.e. consumer habits, demand patterns etc. This reflects whether e.g. the customary business practices and roles of buyer are similar to what the company is used to in its home market.

## 4.2 Opportunities on emerging markets

This subchapter will briefly present some noteworthy advantages and opportunities the emerging markets in general have to offer for internationalizing enterprises. Most of

these features are presented somewhat in comparison to the situation on developed markets.

The emerging markets have plenty of opportunities to offer for the foreign companies. Even if many of these opportunities are alike with the advantages gained through internationalization in general, some of them are unique for emerging markets. By participating in emerging market development, a company may strive for the following principal advantages (Miller 1998, 13):

- Added sales volume
- Economies of scale
- Increased profits
- Improved competitive ability
- Reduced market dependence
- Improved immunity to cyclical fluctuations
- Stabilizations of production schedules
- Reduced effect of market saturation
- Prolonged product life cycles
- Enhanced investment profiles
- Greater growth opportunities
- Reduced levels of competition
- Possibility of large potential markets
- Reduced cost of market entry

Although the most important opportunities are here truncated under just two major features, *high market potential* and *less intensive competitive environment*, they should be more than enough lucrative for internationalizing companies to take emerging markets into notice when screening potential targets for export operations.

A study was carried out in 2000 to assess the motives for retailer internationalization to Central and Eastern Europe, to Poland, Hungary and Czech Republic to be more precise. According to this study, the top three motives were (in this order) to increase sales, possible EU enlargement to the host country and future prospects of the host country. (Tatoglu, Demirbag & Kaplan 2003, 46)

#### **4.2.1 *High market potential***

Several features affect the markets and consumer behaviour of a region. Such underlying factors as climate and geography have to be certainly noted, along with e.g. population characteristics. The purchasing power of people is determined by income and wealth, so these features are undoubtedly rather relevant. Not so surprisingly, level

of income is a major determinant of demand for consumer durable goods for example. (Albaum et al. 2002, 85)

As mentioned several time already, in order to be categorized as an emerging market (both universally and in this study), a country has to be undergoing a significant and long-term economic growth. This is usually measured by the growth rate of GDP or GNP per capita.

The high level of economic growth and the consequential rapid economic development in emerging economies have led to a rapid growth of income levels. In addition, the levels of population growth in emerging economies are notably higher than they are in the industrialized countries. These features raise high expectations: the vast (and increasing) amounts of people in developing areas are making more money and “westernizing” their way of life. Hence, they are believed to create a high demand for various products, thus assuring high returns for companies operating in their region. (Bilgin, Sriram & Wührer 2004, 29)

A part of economic development is the change in demand patterns. As the private sector in emerging economies strengthens, the infrastructure requirements increase. This leads to an even greater demand for industrialized countries’ exports. Increasingly sophisticated products and services will be in demand, thus opening more possibilities for international enterprises. (Miller 1998, 11-12)

Another notable opportunity presented by the emerging markets is that as the markets in developed countries tend to be somewhat mature and saturated, the emerging markets offer an opportunity for companies to seek high growth for sales. Moreover, the developing countries may offer a possibility to amend hiccups in sales on more developed markets. For example, in the period of 1991-1993 majority of the developed countries were experiencing at least some level of recession. Even then, the developing countries were able to maintain high levels of economic growth, and provided for almost 75% of the increase in world exports. In that period, e.g. the growth of USA exports to developing countries was five times faster than exports to traditional trading partners. (Miller 1998, 11)

Not only retailers are expected to enjoy the economic growth in emerging economies, but actors in the business-to-business field as well. One of the main engines of growth and economic development is the liberalization of trade and industry. One important element of this liberalization is the privatization of state-owned enterprises. After the collapse of communism, in Russia alone at least 75,000 business units have been privatized. This process is still ongoing, mainly due to the privatization of state-controlled services. Some predict that over the next 20 years, over \$ 6 trillion privatized assets will be sold. In addition to the possibility of investing in emerging economies, the newly privatized enterprises are seeking to expand and develop their business, thus

opening opportunities for enterprises from developed countries to offer e.g. machinery and expertise for sale. (Miller 2000, 73-77)

These opportunities also make demands for the internationalizing enterprises. Partner Pekka Vanne from Boston Consulting group reminds that if an exporting company wishes to be successful on a given emerging market, it usually has to alter many aspects in its customary ways and business practises simultaneously. Companies from industrialized countries are usually used to setting their goals for sales to somewhere under 10 percent of annual growth. However, on rapidly growing markets this target should be from 30 percent up to as high as 300 percent annual growth. This demands significant effort from the company in terms of strengthening and adapting sales, production, distribution, service and organizational capabilities. Vanne emphasizes that it is crucial for an exporting company that its managers and essential employees understand the nature of the constantly changing operational environment on emerging markets. (Remes 2008)

#### ***4.2.2 Less intensive competitive environment***

Competition has the most direct impact on a firm's strategic decisions and operations. The level of competition on a given (foreign) market can be assessed by using such indicators as e.g. entry barriers and capital commitment. Thus it is quite natural that companies tend to prefer markets with lower levels of existing rivalry as target markets. (Luo 2002, 23)

As has been mentioned several times in earlier parts of this report, smaller companies have limited possibilities to put up with rigid competition as they are usually in a weak position to negotiate and thus have limited possibilities to influence the surrounding world. Their strengths are in differentiating products and offering flexible service, not in waging "price wars" with their larger rivals. Thus less intensive competitive environment could seem lucrative for them in order to search for better earnings and faster growth.

This is exactly what the emerging markets usually have to offer for multinational enterprises. On emerging markets, there is often no local competition especially when it comes to advanced technologies and more sophisticated customer products. And usually it could be claimed that the less developed of an economy, the less there are foreign enterprises present to compete with. And the foreign companies that are present have usually had less time to develop their distribution channels and customer loyalty. (Miller 1998, 12)

Also in many cases, imported Western goods have a higher prestige on emerging markets than do locally produced products. The customers in emerging economies are

usually also more easily reached in terms of marketing than customers in industrialized countries. This is firstly due to the lower level of competition and secondly the type of advertising used in gaining the customers' attention: in industrialized countries, the expensive television and radio advertising is commonly used whereas in developing countries e.g. billboards offer an effective and inexpensive marketing channel. (Miller 1998, 12-13)

If the exporting SME is less-experienced in doing international business, the emerging markets offer the advantage that all companies start on relatively equal basis. Business networks are yet to be established and a company can participate in this process instead of trying to force its way into existing networks. Only few of the entering organizations will have knowledge and understanding of the country's operating methods and needs, so all actors are in a sense going through a learning process. (Miller 1998, 15)

### **4.3 Challenges on emerging markets**

The challenges of exporting can also be called export barriers. These barriers may be real, realizable or merely perceived. However, regardless of the nature of these obstacles, the smaller companies tend to have hardest time handling with them. (Albaum et al. 2002, 21)

The previous subchapter praised the opportunities the growing markets in emerging economies have to offer for Western companies. As things tend to have many sides, there are reasons why not every internationally active company have entered the emerging markets, and what should be taken into account when entering these markets.

The emerging markets are almost without exception more volatile and have more risk factors than the developed countries. Furthermore few emerging markets reach their full potential without occasional reversals. In addition, it has to be kept in mind that in some cases, the developing country never reaches the fully developed stage. (Miller 1998, 47)

Obviously every business operation bears some level of risk. Still some risks are somewhat typical for the emerging markets. The risks and challenges involved in doing business in developing economies are scrutinized in this subchapter.

#### **4.3.1 *Payment risk***

It is rather common for emerging market export operations to fail due to inability to collect payment for already delivered goods. Long delays in payment can also quickly

erode international profits and put a company's entire cash-flow position in jeopardy. Credit and collections are in all cases a crucial part of a company's ability to operate on a healthy basis, and this aspect has to be emphasized when operating on the (sometimes highly) volatile developing markets. In these areas, the payment risk is made more severe also by the possibility of harsh regression. E.g. Latin America suffered major economic problems in the early 1980's. During this collapse, exports to the area from developed countries fell dramatically. (Miller 1998, 51)

Although Miller (1998, 51) reminds that it is not only the novice and small exporting companies that suffer from credit losses, it could be argued that for SMEs this risk is higher. As Johnson & Turner (2003, 132) point out, dire need for capital and uncollectible due to unknown payment ethics are the obvious weaknesses of internationalizing SMEs. This suggests that the smaller companies truly have to prepare themselves for problems in collection of foreign debt, as even smaller sums can be of great importance to them.

Currency risk is an additional aspect of payment risk. Especially if the exporting company is active in less-developed market areas, the local currencies tend to be very soft, i.e. illiquid and unconvertible. In countries with soft national currencies, a risk of monetary devaluation tends to be present. This is the case especially if the currency is centrally controlled by government officials. The currency risk can be avoided by e.g. dollar-denominated pricing and even barter. Neither of these is however always profitable or even possible. Some developing countries have for example placed restrictions on the internal exchange of local currencies for foreign debt payment. (Miller 1998, 52-53)

In business-to-business trade in developed economies the payment risk is usually reduced by simply assessing the financial capacity and stage of a potential customer and only after this deciding whether to deliver the wanted goods or not. On emerging markets however, this is not always possible due to the unavailability of such information. This is again due to the frequent lack of regulations regarding company financial statements. Possible sources for customer credit information include e.g. international banks and other companies that are active on the market in focus. (Miller 1998, 54)

With selecting proper method of payment, the exporting company can significantly reduce the payment risk even in developing countries. These different "protective" methods of payment include at least *cash in advance*, different forms of *letters of credit*, *drafts*, *open account*, *consignment selling* and, as a last resort, *forfeiting*. (Miller 1998, 55-61)

### 4.3.2 *Inadequate infrastructure*

Developing, building and maintaining physical infrastructure is costly. Emerging economies, even with their high economic growth rates tend to have limited funds to allocate for public project. Furthermore, these funds are sometimes used for purposes that do not directly support the country's economic development at all, e.g. military programs. For example Russia and Peru spend large proportions of their budget to development of armed forces, even though transportation infrastructure in these countries is in a poor condition. (Miller 2000, 192-193)

The military spending in the poorest regions of the world is a saddening phenomenon, especially when it's carried out in the expense of the well-being of nation's common people. Proper infrastructure is undoubtedly a key element for economic development. As one researcher puts it:

*Inadequate infrastructure, whatever the cause, delays national development and usually makes market entry more difficult for foreign business interests. Any company that wishes to form a strategic alliance with a newly privatized company, or to market to newly established enterprises will be invariably required to depend on that country's infrastructure to transport products, power its facilities and provide the ability to communicate with customers.* (Miller 2000, 195)

Obviously many countries simply lack the financial resources for developing infrastructure for transportation and telecommunication. Some international agencies, such as the World Bank, have been supportive in funding these development programs. However, some countries are reluctant to accept this aid because of distrust of foreign interference. (Miller 2000, 193-194)

The concept "infrastructure" bears many meanings, and its inadequacy can thus affect an exporting company in many ways. The three major aspects of infrastructural deficiency, and how they may affect an exporting company, are scrutinized in the following paragraphs.

The *communications infrastructure* is an important factor to companies from industrialized countries, as they are usually highly dependent on voice communications, e-mail and fax. However, even in the newest EU members for example telephone lines etc. are still outdated and insufficient. The lack of possibility to communicate in a customary manner may be an obstacle too great to pass for some exporting companies. (Miller 2000, 196)

Enterprises need electricity (manufacturers more than sellers), and it will not be available if the *electrical power generation* is inadequate. In the retailing industry, high

cost of electricity can affect households' purchase of e.g. electrical appliances. For enterprises, a high cost of energy seriously affects the competitiveness. (Miller 2000, 197-199)

Transportation limitations derive from poor condition of road, rail, air and water *transportation infrastructure*, i.e. roads, railroads, airfields etc. In many cases a company expanding its activities to emerging markets expects rapid growth. This can prove to be virtually impossible to achieve if the exporting company can not arrange its logistics and distribution properly due to inferior infrastructure. In developing countries, the transportation infrastructure and equipment is in many cases outdated, and can be even hazardous. Yet the importance of the condition of roads and railroad is significant, and is even emphasized in geographically large countries such as Russia, Brazil and China. Furthermore, the entire transportation system should be designed in a manner where changing the modes of transport is as frictionless as possible. (Miller 2000, 199-203)

#### **4.3.3 Government regulations and trade barriers**

In industrialized countries, foreign companies do not need legislation to protect their assets as the economic and political stability takes care of this without special laws. In advanced economies, procedures seldom discriminate the foreign companies. Furthermore, anti-monopoly regulations are common. These framework conditions should not be taken for granted when operating on emerging markets. (Luo 2002, 40)

Although things have changed from the 1980s and 1990s when many developing market economies were characterized by high barriers of entry and strong governmental control, the emerging markets are still infamous for their policy shifts. For example, weakening economic growth in some countries, e.g. Russia and Indonesia, created pressure for the countries to lure in more FDI. At the same time, these countries were pressuring MNEs to decrease their exports. Although in order to be regarded as an emerging economy a country has to be liberalizing its economy, the drastic changes in economic and institutional environment have created regulatory uncertainty. (Luo 2000, 41-43)

Regulated industries, such as telecom, banking and the Internet for example, are rather vulnerable in the sense that governments are sometimes eager to increase their control and lessen the market position of foreign companies. E.g. in China, the government published new regulations for providing Internet content in 2000. This regulation forces all companies that wish to provide e.g. news or information about health care on the Internet to apply for a license to do so. China also restricts harshly what content can be provided on the Internet. Companies violating these rules face the

threat of being shut down or at least receiving a mentionable fine. The reason why the newly opened industries are often regulated harshly is simply that they are growing and developing so fast that the legislators are having trouble to keep up. On the other hand, the regulations give authorities the possibility to intervene with MNE operations if they see that it is for some reason necessary (Luo 2000, 50-53)

Countries may also impose import restrictions to boost the sales of domestic products. These can apply to everything from raw materials to machinery. Although import restrictions are usually imposed with best intentions, they just tend to hamper well-doing businesses. In addition to elevated costs, restrictions may cause severe problems if there is not an adequate supply of some critical products. (Cateora & Ghauri 2000, 53)

Import restrictions are a form of *trade barriers*. Although a company may run into these barriers wherever, the higher level of governmental control in emerging economies may cause that they are more common in the developing countries. Hence, the different kinds of trade barriers are briefly presented in the following.

A *tariff* is a special tax imposed by the government to a certain product. Agricultural and textile products are common commodities regulated by tariffs. A country may also impose *quotas* on certain goods. This means that the amount (units or value) of goods imported in a certain period may not exceed the imposed limit. (Cateora & Ghauri 2000, 35-37)

*Monetary barriers* mean the various forms exchange-control restrictions. A country may block currency as a political weapon. A differential exchange rate means that for favourable products, the exchange rate of currency is better than for products which imports government wishes to restrict. One mode of monetary barriers quite commonly encountered in emerging economies is that *government approval is required for foreign exchanges*. This mode forces all foreign exchange transaction to be approved by a ministry or a bank. This permit may also dictate the exchange rate. Furthermore, the funds may have to be deposited at a local bank months before the actual import date. These measures cause significant cash-flow problems and increase the price of imports. (Cateora & Ghauri 2000, 37-38)

A *boycott* is the ultimate trade barrier as it absolutely prevents the imports of certain goods. A boycott does not even have to be imposed by the government, but it can also originate from civic organizations etc. Although not official restrictions, the latter situations may also be a major obstacle of exporting. (Cateora & Ghauri 2000, 37)

Especially the General Agreement on Tariffs and Trade (GATT) and afterwards WTO aspire to eradicate the trade barriers. Although WTO has nearly 150 members, trade barriers still exist. (Cateora & Ghauri 39-41)

#### 4.3.4 *Political risk and bureaucracy*

As so much is happening so fast in the emerging economies, it is quite understandable that not every person or quarter is pleased with the changes taking place. All the emerging economies have had state-controlled economy, and many of them are former socialist countries. Amongst the emergence lie different types of *political risks*.

In the former communist countries, the main source of political risk is the possibility of the government and officials to turn back to their old ideological philosophies. Restructuring an entire country's economy and politics to free-market and democracy requires massive amounts of legislation etc. In this transition period, a country may lack an effective system of law and financial control. The lack of competitiveness may result in unemployment and reduced living standards. As the communist system was based on the idea that everyone had a job, prolonged transitional period may boost sentiments that everything was better before. In addition, when the national governments change, it is not obvious that the new legislators share their predecessors' enthusiasm to open trade and support FDI and exports to the country. (Miller 1998, 86-87)

As mentioned already in the preceding subchapter, in the worst-case scenario, the officials in a developing country may seek to gain more benefit from the earnings of foreign companies by suddenly presenting new laws and regulations. The most severe form of this is confiscation, where the government seizes a company's assets without payment. In expropriation the assets are seized, but returned against reimbursement. Sometimes governments may also wish to domesticate foreign-held assets by mandating e.g. ownership to be transferred partially to nationals or a greater number of locally produced components to be used. (Cateora & Ghauri 2000, 50)

As the government and public officials have so much influence in emerging economies, the level and amount of *bureaucracy* involved in exporting operations can sometimes seem overwhelming for international enterprises. Luo (2002) sees that the unnecessary red tape can sometimes be avoided by building personal relationships with public officials. Still it could be argued that in many cases, the bureaucracy is just an unpleasant feature with which companies merely have to live with.

For example Myllykoski, a Finnish paper company, had planned to establish a paper mill to Opatovice in Czech Republic as a joint venture with its partner Labe Papir. Everything was supposed to be in order, as the location for this investment worth 450 million euros was selected and Labe Papir had negotiated a 170 million euro loan from European Investment Bank for funding this project. The alliance was convinced that an investment of this magnitude was needed in Central Europe, and as an EU member, Czech Republic offered a lucrative target for this. But the Czech officials did not make life easy for the paper alliance. After a year's struggling with the red tape and delay in starting the construction, Myllykoski and Labe Papir were forced to cancel the

investment in 2006 and relocate it to Plattling, Germany, 50 kilometres from the Czech border. As Sverre Norrgård, CEO of Myllykoski puts it: “It has been a disappointment to us, that even if Czech is an EU member, getting the right permits is so difficult and time-consuming. We did not expect this much of uncertainty, although we knew that things would not go as smoothly as in Finland or Germany.” Myllykoski estimates that it lost “a few million euros” in planning and arranging this project, yet a bigger damage is inflicted by lost sales. Also the terms of the already granted loan have to be renegotiated. (Pöysä 2006)

#### **4.3.5 Corruption**

Corruption breeds from complex regulatory systems administered by ineffective bureaucratic structure. Once present, corruption can have significant ill-effect on a country’s economy. Unfortunately this is a common feature on many newly-privatized markets, from South-East Asia and South America to Eastern Europe. Due to the large number of people with low income, the emerging economies are extremely vulnerable to the occurrence of corruption. As government official tend to have especially low income, it seems rather lucrative to improve their standard of living through bribery. (Miller 2000, 177-179)

To assess the effect of corruption, a “bribe tax” on companies’ revenues was calculated in 1999 by A.C. Nielsen and the European Bank for Reconstruction and Development. Back then this “tax” varied in the former Warsaw Pact countries from 2,5 % in Poland up to 6,5 % in Ukraine. According to another survey conducted in 1998, the most corrupt countries in Asia were Indonesia, India and China. (Miller 2000, 179-181)

Corruption has many negative effects. Having to pay bribes in order to be able to operate in a given country cuts companies’ revenues as mentioned in the preceding paragraph. It is also suggested that in corrupted countries, less of their GDP goes into investment resulting in lower economic growth rates. Education also suffers as there is no one to “pay off” the officials to grant funds for schools etc. Corruption hinders foreign investment and weakens a country’s privatization ability. (Miller 2000, 185-186)

The level of corruption in countries around the world is monitored by Transparency International, who publishes every year a ranking of countries. This assesses the degree to which officials are involved in corruption. The index is based on the perceptions of employees of multinational firms, hence it can be somewhat biased. Still it works as an indicative tool for assessing the level of corruption in a given country. (Miller 2000, 188-190)

#### 4.3.6 *Other challenges*

The challenges presented in the preceding subchapters probably form the most common obstacles in the way for companies expanding their operations to emerging markets. Other challenges however exist, although they may not be as difficult to overcome and thus pose less significant threat to foreign enterprises.

One possible challenge for multinationals is that they may find themselves in a situation where they have to *compete with a state-owned enterprise*. Although it is common for the emerging economies to be going through extensive privatization programs, the state-owned enterprises may still dominate, if not the economy, at least their industry sector. The state-owned enterprises tend to be receiving subsidies and government may even aim to hinder competition by imposing taxes etc. for private enterprises on the same industry. Government officials tend to be extremely cautious towards multinational enterprises, and in some cases do everything in their power to prevent the fair competition in state-controlled industries. (Miller 2000, 204-205)

The Trade and Development Index brings out additional challenges. E.g., even the most developed ones among the emerging economies score extremely low on the human capital –index, which bases on education and health expenditures (Developing countries in... 2007). Low level of education usually means illiteracy and lack of language skills among the people, which in turn may cause challenges in various ways.

## **5 RESEARCH DESIGN**

In this chapter, the methodology used for carrying out this research will be presented. In addition to presenting the used research methods and the data collection process as a whole, also the validity and reliability of this report will be evaluated as well as possible.

### **5.1 Research approach**

The preceding chapters have presented the used theoretical background. The researcher has aspired as wide use of information sources as possible. Theories by recognized scholars have been used as the backbone of this research, as the latest views and ways of thinking have been searched from articles in journals, newspapers and even on the Internet.

This theoretical background presents massive amounts of numerical data on SME internationalization and exports. Still it seems that the views of the actual people involved directly to SME internationalization, especially when it comes to exporting to emerging markets, has somewhat be neglected. It is virtually impossible to find studies on the strengths and weaknesses of smaller companies in doing business to industrializing countries.

Hence, this study could be said to be explorative in nature. In this type of situation, qualitative research is quite commonly used. Consequently, qualitative research seems as an appropriate tool for this specific research as well. (Hirsjärvi, Remes & Sajavaara 2004, 129)

Through qualitative research, it is possible to describe phenomena as they are perceived in real life. This method also allows the use of people as a main instrument for gathering information. In addition, it releases the researcher from the necessity to use random sampling when deciding the research subjects. (Hirsjärvi et al. 2004, 152-155)

To put this research to a time frame, the underlying theories will be first gathered and studied to the extent where the researcher should have adequate information concerning the studied phenomenon. Then, the empirical data will be gathered, i.e. the theme interviews will be held. Finally, these interviews will be analyzed and conclusions made for the final report.

## 5.2 Data collection

As it has already been stated, this research can be described as being explorative nature and will be carried out as qualitative research. So what is left is deciding the appropriate method for collecting the empirical data. According to Hirsjärvi et al. (2004, 194), in qualitative studies, interviews are commonly used.

Interviewing as a method for data collection offers many advantages. It is especially useful in situations where only little is known of the studied phenomenon and the purpose is to deepen the understanding of that phenomenon, as is the case in this research. Interview is also an extremely flexible way of gathering information. In addition, it is possible to select the interviewees that could possibly give valuable information instead of using e.g. random sampling. The negative sides of interviewing are that it is rather time-consuming, and that people may give unreliable answers on personally sensitive questions. (Hirsjärvi et al. 2004, 193-196)

In this case, the positive sides exceed the negative effects. The people interviewed will be addressed as representatives of their companies instead of private persons. Furthermore, this topic can not be seen as being very sensitive in nature. Hence interviews will be used as the data collection method in this research. However, the fact those interviews are rather time-consuming remains. Hence the number of interviewees will have to be limited. And as the mode for these interviews, theme interviewing is selected in this research.

Theme interview is the intermediate form of structured and open interview. The idea of theme interview is that the topics of the interviews are known, but the precise form of the questions is not. Theme interview corresponds well to the foundations of qualitative research. (Hirsjärvi et al. 2004, 197)

Theme interview, or semi-structured interview, is ideal when discussing topics the interviewees are not used to assess or rationalize. When carrying out theme interviews, four issues should be taken into account:

1. *Wideness*. The interviewees should be given the opportunity to bring out all the aspects they see important.
2. *Specificity*. The interviewees' reactions should be as specific as possible.
3. *Depth*. Different meanings of the researched phenomenon to the interviewee should be studied.
4. *Personal context*. The personal characteristics and experience of the interviewees should be studied. (Hirsjärvi & Hurme 1988, 35-36)

Theme interview seems as an appropriate method for collecting data for this research. Not so much is known of the studied phenomenon, so it could be too challenging to come up with the right questions. Also more should be learned from each interview. Hence every interview should be wider than the preceding one. Hopefully the

interviewees will also answer the questions the research does not for some reason understand to ask.

### **5.3 Case companies**

This chapter is dedicated for presenting basic information of the selected case companies and the interviewees. First, the selection process of these case companies will however be presented briefly. Although this is not a case study as such, the term “case company” will be used to refer to the companies from which data is gathered for this research.

#### *5.3.1 Selection of case companies*

As mentioned earlier, the method used for data collection will be theme interviewing. These interviews will be carried out in selected Finnish companies during spring 2008. The only actual prerequisites for the selected companies are SME-status and ongoing export operations in countries that can be categorized as emerging economies.

But as there are around a quarter of a million SMEs in Finland according to the Central Statistical Office (Katsaus yrityksiin ja toimipaikkoihin 2006) and a great deal of these are involved in exporting, only a small proportion of these can be studied and further limitations are obviously necessary. For logistical reasons, companies operating from southern Finland will most likely be selected. It is rather certain that also the possible rejections of requested interviews will somewhat affect the selection process. Still the most lucrative potential case companies will be approached.

After selecting the target companies for the field research, the main criteria in selecting the actual interviewees from these companies is clearly their undisputable and direct participation in the company’s export operations. Hence, people working in the company as for example export managers, salespersons and logistics controllers will be highly favoured as potential sources for interviews. Also the quality of potential interviewees will affect the case company selection process, as it does not seem reasonable to interview people from whom adequate information can not be expected to be received for some reason.

### 5.3.2 *The three selected case companies*

Finally, three case companies were selected: *Hankintatukku Oy*, *Hitsaus- ja rakennustyö Aho Oy* and *Merimet Oy*. All of these companies fulfil the prerequisites for qualifying as a case company for this research. In addition, all the companies and their representatives were very cooperative, thus making it possible to gather reliable and useful information for this research. All the interviews were carried out intentionally within a rather short time frame, in order to maximize the benefits of theme interviews. One already selected case company, *Fennobon Oy*, had unfortunately to be left out from the research due to the sudden falling ill and preceding long holiday of the interviewee.

All of the interviews were carried out in the premises of the case companies. The interviewees were asked to reserve at least an hour for the interview and this limit was not exceeded in any of the cases. Before the actual interview, it was made clear that the information gathered from the interview will be used in a public master's thesis and that in order to prevent something from getting written on this report, the interviewee should mention about it.

*Merimet Oy* was the first company to be interviewed on 17<sup>th</sup> March. The interviewee was Matti Riihimäki, who has worked as a logistics engineer in the company for little less than two years. The actual interview lasted for 45 minutes. Mr Riihimäki is responsible for the export deliveries, although he does not make exporting decisions as such. The interview went smoothly and was carried out in a negotiation room. The only disturbance was another employee who came to inform the interviewee that the next delivery to Estonia was ready to be shipped out. Mr Riihimäki wishes that their major customer would not be mentioned in this report. Hence he refers to it as "our important domestic customer".

A day later, on 18<sup>th</sup> March, it was time for the next interview. The second case company visited was *Hitsaus- ja rakennustyö Aho Oy*. 37 minutes of recorded interview was collected from Arno Sjöblom, the production manager of the company. He has worked for the company for around five years and is responsible for export contracts, communication and deliveries. The owner-manager, Jari Aho still keeps all the power to decide concerning new customers etc. However, Mr Sjöblom could be regarded as the "second in command" when it comes to export-related decisions. Thus he was able to give exquisite information on the operations and history of the company. His phone rang a couple of times during the interview as the interview took place in his office, but the calls did not disturb the interview significantly. After the interview Mr Sjöblom requested that the name of one of their customers he talked about in the interview would not be mentioned in this report, which was naturally promised.

The final interview at *Hankintatukku Oy* took place on 26<sup>th</sup> March. The export director of the company, Matti Kaarlas, was in a talkative mood as the interview lasted

for almost an hour. Of these three interviewees, Mr Kaarlas was the one with most experience and authority regarding company's export operations. He has worked for Hankintatukku Oy since 1989, and is the one who makes all the decisions regarding exports. In addition, Hankintatukku Oy is the one with the most extensive export operations of the three case companies. It is also the only case company with an actual exports department, as Mr Kaarlas has two regional export managers as his subordinates. Also this time the interview was conducted in the interviewee's office, but no interferences was encountered.

### 5.3.3 Comparison of the case companies

The underlying idea was that different types of companies would be selected for case companies. This means that the case companies would operate in different industries and would have different kinds of operations on different emerging markets. Although these companies and their operations will be scrutinized more thoroughly in the forthcoming chapter, table 3 presents some basic information of the three case companies.

Table 3 Comparison of the case companies

	<b>Merimet</b>	<b>Aho</b>	<b>Hankintatukku</b>
<b>Industry</b>	Industrial subcontracting	Industrial subcontracting	Pharmaceuticals, natural products
<b>Established / Exporting begun</b>	1983 / 21 <sup>st</sup> century	1984 / 2005	1982 / 1985
<b>Locations</b>	Karkkila	Karkkila, Karjaa	Helsinki, Karkkila
<b>Owner-Manager<sup>9</sup></b>	No	Yes	With limitations
<b>Turnover (approx.)</b>	9 M€	5,6 M€	14 M€
<b>Employees</b>	60	50	65
<b>Exports (% of turnover, approx.)</b>	10 %	5 – 10 %	30 – 35 %
<b>Host countries</b>	China, India, Estonia, Sweden	Poland, France, Sweden	Over 50 countries worldwide
<b>Export mode</b>	Direct selling (contract with dom. customer)	Direct selling, Indirect exporting	Direct exporting
<b>Separate export dept. in company</b>	No	No	Yes

Clear similarities can be noted between Merimet and Aho. Both are industrial subcontractors and rather same sized when measuring by turnover and amount of employees. Also the percentage of exports from annual turnover is roughly at the same

<sup>9</sup> Refers to whether the company is managed by an owner-manager or not

level in both of these companies. However, Hankintatukku differs significantly from the two other companies by almost all indicators. It sells consumer goods to retailers instead of industrial components to business customers. Hankintatukku also has significantly higher turnover than the other two case companies. Furthermore, the meaning of exports it at a completely different level for Hankintatukku than it is for Aho or Merimet.

For the research it is a welcomed feature that all of these three companies are exporting to somewhat different parts of the world. Hankintatukku however has the widest customer network as it has ongoing export operations in over 50 countries and all continents. Also the export modes used differ between these companies, Merimet perhaps using the vaguest mode of these companies as it sells and delivers directly to foreign customers but agrees the prices with their domestic representative.

An interesting, although perhaps meaningless, similarity among these case companies is that they have been established within a time frame of only two years. All these companies started as sole proprietorships (Hankintatukku has two founders). What makes this interesting is the fact that in a sense, all of these three companies have had the same amount of time to reach the stage they are at and build up their present networks.

So the case companies have differences in size, host countries, export modes etc. Thus also the amount of applicable information gathered in the interviews differs significantly. Furthermore, the interviewees are in different positions in the companies they represent. Hence it is understandable that the amount of information and analyzing provided from each case company in chapter 6 will somewhat differ. None of the case companies is intentionally emphasized and they are treated as equally important sources of information for this research.

## 5.4 Quality of the study

The quality of a study is determined by assessing the *reliability* and *validity* of that study. As this study bases on qualitative research, the reliability and validity of it are somewhat ambiguous to evaluate. However, there are indicators by which both of these features can be assessed simultaneously. (Hirsjärvi & Hurme 1988, 129)

First aspect of evaluating the validity and reliability of qualitative research (when using theme interviews for data collection) is *concept validity* (Hirsjärvi & Hurme *ibid.*). In order to maximize the concept validity of this research, the theoretical background is composed with great care. The concepts used in this study are scrutinized, presented and evaluated as thoroughly as possible. This allows the interviewer to guide the course of the interviews more precisely.

These aspects also affect the *concept validity* of the research (Hirsjärvi & Hurme *ibid.*). As the topics for the interviews are selected with care, and more is learned in every interview, it should be guaranteed that at least eventually the right questions are to be asked. Errors can also occur from the *interviewers* (Hirsjärvi & Hurme *ibid.*). As for this research, only one person will conduct all the interviews, so there should be no inconsistency relating from the interviewer.

The validity of the *interviewees* is guaranteed by selecting only people actually responsible for the export activities for interviews. The content of the interviews will not be *transferred* anywhere, but the tapes itself will be used to analyze the material. Therefore, no data will be lost in transferring.

The author takes full responsibility for the *validity of the conclusions* presented in this report. However, it is guaranteed that no conclusions will be made without comparing the finding to the underlying theoretical background.

## 6 EMPIRICAL RESEARCH FINDINGS

In this chapter, the information gathered from empirical research through theme interviews will be presented. These findings are scrutinized on case company –level, and each case company will be addressed in the same fashion. Although all ongoing export operations are presented more or less, the emphasis will be clearly on the operations carried out in emerging economies. The case companies are studied in the same order as the interviews were conducted.

### 6.1 Merimet Oy

First company to be presented for this research is Merimet Oy. Merimet is a machine shop that has specialized in subcontracting. Its main customers operate on the engineering industry.

The story of Merimet Oy begins in 1984 when the founder, Seppo Meri, decided to go on a business by himself. He bought a lathe and started machining components in his parents' empty barn in Karkkila. Today, the barn is empty but beside it lay two halls in which 60 employees are responsible for generating an annual turnover of around 9 M€ Mr Meri has retired from operational responsibility and acts as the chairman of the board.

Merimet's core competency is machining iron and steel components. Excellence in machining is where the company seeks for competitive advantage. Although Merimet has facilities for e.g. welding and painting, their main function is to support the machining services. As most machine shops, Merimet would also prefer high level of commitment with customers, i.e. long contracts making it possible to manufacture components in series. Manufacturing in series makes it possible to improve the processes and enables more efficient production management.

#### 6.1.1 *Export operations – past and present*

At the moment, Merimet has export operations on three emerging markets: Estonia, China and India, listed on the same order as is the value of the exports for Merimet. In addition, Merimet exports some components to the not too distant Sweden. From the emerging target markets, China is the most long-standing. There Merimet has been active for a few years. Exporting to Estonia was initiated roughly in late 2006. Mr Riihimäki presumes that Estonia came into the picture simply due to Merimet's

customer transferring its production from Finland to Estonia in order to cut down the costs. Finally, the first orders to Merimet from India were received in December 2007.

As is the case for many industrial subcontractors, Merimet has its large customer, an MNE with significant presentation in Finland, to thank for the ongoing export operations. The customers in Estonia, China and India are all subsidiaries of a large domestic enterprise, and the Swedish customer is a subsidiary of another large Finnish industrial company. The possibility to initiate exporting has presented itself in the same fashion in every case: the large company, which is already an important customer to Merimet, has opened a foreign subsidiary. As products assembled in these foreign subsidiaries are similar to the ones produced in Finland, they have somehow received the information that certain components can be ordered from Merimet. How this information made its way to the ears of these foreign subsidiaries is not known, probably the customer of Merimet has some sort of worldwide database from which information on potential component suppliers can be retrieved.

These foreign subsidiaries buy components from Merimet according to a contract Merimet has with the Finnish parent company. All daily routines and dealings are however taken care of directly between Merimet and the foreign actors. It should be mentioned that all the employees Merimet is dealing with on the target markets are locals; there are no Westerners that would take care of e.g. purchasing from Europe. All in all this is a somewhat peculiar way of handling exporting and does not fulfil the description of any of the main export modes. It is rather a combination of both direct and indirect modes.

The day-to-day business with the foreign customers is mainly carried out by e-mail, and as for India and China it is almost a necessity due to the differences in time zones. Everything is taken care of in English, no matter which host country is in question. The contracts do not oblige the customers in any way, only the prices are agreed on. The prices are agreed on based on ordered quantities, so larger orders mean lower prices. As the prices have been negotiated with the Finnish business unit of the large MNE, no negotiations with the foreign customers have been needed.

Mr Riihimäki is the one who is responsible for taking care of the exporting routines, such as deliveries, received purchase orders etc. It has to be mentioned however that as he is a logistics engineer, he takes care of export-related issues among other responsibilities so Merimet does not have a person that would be solely responsible for export operations.

Mr Riihimäki does not see that there are great differences in the ways of doing business between domestic and foreign companies. Especially Estonia has rather similar business culture than Finland. Actually Merimet's Estonian customer has been even somewhat easier to deal with as they have always delivered order prognoses when asked for, which have been close to impossible to receive from Finnish customers. The

Estonian customer also seems to stock large amounts of components for some reason. The difference in Chinese way of doing business expresses itself in constant inquiries, i.e. Merimet is requested to inform on the status of the deliveries over and over again, even though they have not had problems in keeping the agreed delivery times.

The Chinese customer wishes to monitor Merimet's activities far more closely than any of their domestic or foreign customer, and as many of their customers are business units of the same corporation, this could be seen as being a purely Chinese feature. Perhaps this is a feature learned from the centrally-planned economic system where everything is closely controlled.

From India Merimet received several invitations to submit tenders. However, only few of these have so far led to placing of actual purchase orders. Mr Riihimäki sees that for the Indians, the price level of Merimet is simply too high. Sadly for this research it is not known from where does Merimet's Indian customer by the majority of the required components. The initiation of exports to China was far simpler; the Chinese company merely started placing orders with very few preceding inquiries.

There is not much to say concerning past export operations of Merimet. As far as Mr Riihimäki knows, Merimet has not received invitations to submit tenders from abroad. Hence, no export operations have been rejected. Some years ago Merimet exported components to France but for some unknown reason the customer stopped to place orders.

### ***6.1.2 Competitive advantages in exporting to emerging markets***

The export operations of Merimet are all the consequence of their domestic operations. Hence it could be considered that their competitive advantage is the quality of their products and their reliability, which have accumulated orders from foreign companies. As Merimet's customer establishes new business units abroad, it is probably much safer to at least at first order components from well-known and reliable suppliers.

Mr Riihimäki sees this the same way. He is confident that it takes time to find corresponding supplier from the new host countries. As new subcontractors from new market areas are sought, many issues have to be dealt with. Once a supplier is found and the quality of its products is confirmed, also a supplier for raw material has to be found. All the needed drawings and instructions have to be delivered to the new subcontractor. The supplier of raw materials needs e.g. casting models, which again are rather expensive. The customer has to be certain that these new suppliers meet the standards required by the customer, and that acceptable components can be obtained using this new business network.

Merimet fulfils all these requirements. So at least as far as the new business unit gets up-and-running and establishes working business networks, Merimet is a safe supplier of components. This way of thinking has its obverse: Mr Riihimäki is rather confident that once their foreign customers manage to find good suppliers closer, Merimet is somewhat forgotten from the list of suppliers. Metal components are heavy, and sending them from Finland to Asia generates costs. The Finnish price level is also known to be high, which probably encourages their foreign customers to seek for other suppliers.

Few of Merimet's advantages only apply on emerging markets, but rather to exporting in general. However, if Merimet is assessed in the light of the SWOT-framework for SME internationalization by Johnson and Turner (2003, 132) presented in chapter 3, points of contact can be found. By utilizing the advantage of its high quality standards and possibility to offer individualized products it has not yet been superseded by the subcontractors in emerging economies. Its ability to adapt to changing market conditions allows its customers to place orders at the pace the components are needed without harming the profitability of Merimet and thus enabling the formation of more efficient processes by Merimet's customers.

Possibly one of the opportunities on emerging markets mentioned, lower level of competition, has had its effect on this issue. It really seems peculiar that after two or more years these customers are still purchasing components from the distant and expensive Finland. Merimet's machinery is not superior, nor does it possess any exceptional know-how. Merimet's main competitive advantages are high quality and delivery certainty. Apparently its counterparts in the developing economies have not yet achieved these features to the extent that they could entirely replace Merimet as component supplier. However, Merimet's Chinese customer has lately cut down its orders. More information on this can be found in the following subchapter.

### **6.1.3 Challenges faced on emerging markets**

Although Mr Riihimäki does not think that Merimet's exports to emerging markets are a mentionable more complex business than selling to domestic markets, some disputes and challenges have obviously been encountered.

Merimet's customer in China requires product codes in Chinese to be attached to packing in Finland. These markings indicate which products are on a given delivery. Still there have been incidents where the Chinese customer has claimed that deliveries do not contain the products listed in the packing list. This is almost impossible due to the process used by Merimet to prepare shipments. These complaints have been taken care of in various ways, sometimes compensatory products have been sent with the next

shipment and sometimes Merimet has refused to compensate these products that have almost without a doubt been on the shipment that has left Merimet's premises.

Mr Riihimäki sees that these problems are caused by the incompetence of the Chinese stockmen. They probably do not understand the Latin alphabet, and get confused even though the products are also labelled in Chinese. And it is probably an easier solution for the Chinese employees to just report that products are missing instead of finding out which products are actually delivered.

Another dispute arose as Merimet raised its prices according to contract due to the rise in the price of raw material. Furthermore it is Merimet's Finnish customer who negotiates the prices of castings. Nonetheless, the Chinese customer claimed that they were not aware of this condition and reacted by cancelling a few orders. Actually, after this case, Merimet has only received orders occasionally from China.

Besides these few incidents, Merimet has not had any troubles in dealing with their customers in the emerging economies. As far as the payment risk goes, the protocol is the same used if a domestic customer would be in question: if invoices would stand unpaid, deliveries would be seized until payment for already delivered goods would be received. Mr Riihimäki also points out that Merimet's single deliveries to customers in developing countries are so minor in value, that even if payment for one or two would never be received, the harm caused to Merimet would be rather limited. "It's more a question of principle."

#### ***6.1.4 Evaluating Merimet as an exporter and the future of exporting for the company***

The significance of exports to Merimet is limited. Since approximately 90 % of the turnover is gathered from domestic customers, the eyes of the company are rather tightly fixed to the Finnish markets. However, a clear majority of the value of exports is generated from only one of the target markets, namely Estonia. Hence, the ending of this specific export operation would have, if not devastating, at least notable effect on the company's business.

From the weaknesses and threats presented in the SWOT-analysis of SME internationalization, most can be found in the activities of Merimet. As their role to their foreign customers is mostly to serve as a back-up supplier, their position to negotiate is highly limited. They have gathered no information on their target markets or have sought for assistance or guidance from e.g. public organizations, nor do they carry out any export marketing. Their export operations base on the information spread by their present domestic customers to their subsidiaries, rather than their own marketing or sales work.

This is however not a sign of incompetence, but rather the result of reluctance to strengthen the role and magnitude of exporting. According to Mr Riihimäki, for example participating to some trade fair abroad has not even been discussed. And as the contracts have already been negotiated, no information on the actual host countries is seen to be needed.

It is a clear goal in the future for Merimet to increase revenues and grow the company in size. Yet exports are not seen as a lucrative measure for this, even though Merimet has had good experiences in dealing with customers even from more exotic countries. In order to take more active role as an exporter, also the organization would have to be strengthened, whilst “there are no guarantees of success”. For now, it is enough for Merimet to receive occasional contacts from abroad and concentrate on the domestic market as it is “easier to do business and negotiate with domestic customers”. Mr Riihimäki sees that export marketing would be difficult to organize as Merimet does not have its own products, but only produces individualized components according to customers’ drawings. Hence they would be forced to market their machining capabilities, and “it is a long path”.

In the near future, exports are not seen to change their significance to Merimet. Exporting is at the moment seen as a time-consuming and risky way of increasing sales. This is however rather understandable at the current situation where the Finnish engineering industry is booming. So far growth can easily be sought from domestic markets. Mr Riihimäki also mentions that if the markets in Finland would start to fade, exporting could come into question as a source for additional growth.

## **6.2 Hitsaus- ja rakennustyö Aho Oy**

The second company studied in this research is Hitsaus- ja rakennustyö Aho Oy (henceforth referred simply to as Aho). Similar to Merimet, Aho is a smallish company that does subcontracting for the engineering industry.

Aho was first established in Karkkila in 1984 as a sole proprietorship by the current owner-manager Jari Aho. From those humble beginnings, the company has grown to the extent where it approaches the magnitude of a medium-sized enterprise. With business units in Karkkila and Karjaa and altogether 50 employees Aho has been able to generate an annual turnover of approximately 5,6 M€

As an engineering subcontractor, Aho’s main products are machined parts that are delivered to (usually larger) engineering companies. These parts include e.g. covers and various kinds of plates for industrial gearboxes. They are almost without exceptions machined based on the design and drawings supplied by the customer. The main materials used for machined parts in Aho are steel and cast iron.

Aho categorizes itself as a medium heavy engineering company. The company has its own machining shop and paint shop, along with machinery with which components can be e.g. edged and cut with a blowpipe when necessary. The purpose is that all the stages of a given component from machining the casting to finishing the part can be taken care off at Aho. The idea of delivering finished components ready for assembly to their customers is the ability from which Aho seeks competitive advantage.

### **6.2.1 *Export operations – past and present***

Although Aho has been able to keep up a steady growth, internationalization has not played a significant role for the company. Aho was only involved in indirect exporting to old EU-member countries. Components are ordered by Kalmar in Finland and then delivered to Sweden and France, without the need for Aho to be in contact with the Kalmar's business units outside Finland.

It took two decades for the more involving export modes (in this case direct selling) and the emerging markets to come into the picture. Aho delivers components to a Finnish manufacturer of heavy vehicles, which for one was able to make a few years ago a significant deal to Poland. These vehicles will be assembled in Poland. Aho, supposedly along with others, was contacted and asked to make an offer to deliver machined components to the Polish assembler of the vehicles in question. Aho was able to close the deal with the Polish company and first deliveries were made in 2005.

It should be mentioned that Aho's Finnish customer has nothing to do with Aho's export operation in Poland as such; contract has been negotiated directly between Aho and the Polish company. This contract determines roughly the quantities and dates of deliveries, yet alterations are possible. All communication happens solely between Aho and this Polish company. Communication is taken care of by phone and via e-mail in English. Production manager Arno Sjöblom is responsible for taking care of the export routines, i.e. orders, deliveries and communication.

Aho does not at least seem to be frightened of the effects of globalization. At least the freer movement of people have been warmly welcomed by Aho. The company has many foreign employees, all of them from countries regarded as being developing economies. This already stipulates that e.g. the company must have people with language skills, otherwise also internal communication would be impossible

Aho does not have past experience on exporting, i.e. no operations have been abandoned or terminated. However the company has received an inquiry whether Aho would be interested in starting to negotiate on exporting components to Russia. This proposal came from a Finnish actor who was apparently gathering some type of network that would offer subcontracting services to Russian companies. Aho refused this

cooperation, as it seemed that it would require additional resources to be spent especially to strengthen the organization.

### ***6.2.2 Competitive advantages in exporting to emerging markets***

Mr Sjöblom is confident that Aho's domestic customer has encouraged the Polish company to consider Aho as a supplier, he sees no other way how would the Polish company become aware of Aho. Hence, a good reputation on the domestic market has acted as a clear competitive advantage on foreign markets as well. Although the Polish company is responsible for the assembly of the vehicles and thus also answers for the quality of the components, good references from the Finnish company have undoubtedly worked in Aho's favour.

Aho also matches the common strengths of SMEs: the products are highly individualized as they are produced by the drawings of the customer. Light organizational structure and efficient manufacturing system allow high level of flexibility. Thus even though deliveries are roughly agreed on in contract, changes can be made with short notification to correspond to the needs of the customer.

There are a couple types of components that Aho delivers to Poland. They are all complicated and require several stages to be accomplished. Especially one of the components is highly complex as manufacturing a finished product requires several separate machining and e.g. welding in between. It took some time for Aho to master this manufacturing process, so it is quite likely Aho was the only supplier that could even offer these products to the Polish customer, and certainly the only one that could guarantee the delivery of components with acceptable quality already from the beginning.

### ***6.2.3 Challenges faced on emerging markets***

Aho has experienced at least one unpleasant incident during the export operation in Poland. Aho had delivered both finished products and spare parts for these products. Obviously the spare parts can also be used to assemble finished products. The Polish company had managed to mix these up or it took a while for them to understand that spare parts do not differ from the components used to assemble finished products. But whatever the case, Aho's Polish customer cancelled one order worth 290 000 € which is a huge sum for a company Aho's size. At the same time, also the purchaser Aho had been dealing with was fired.

Luckily this caused little concrete damage to Aho as the manufacturing of exporter components is started only 3-4 weeks prior to the delivery. Hence the manufacturing of these products had not been started yet. This incident was undoubtedly caused by some mistake in the processes of the Polish customer. It is difficult to say whether it was the result of the developing business culture. It can only be said that this sort and especially this magnitude of mistake has not happened to Aho with the Finnish and Swedish customers in 24 years.

Aho has had some difficulties with receiving payment for delivered components from the Polish customers, and they have been forced to ask for payment several times. This is also something Aho has not experienced with domestic customers. So in order to avoid, or at least minimize possible credit losses, Aho monitors the payments and makes sure that too many invoices are not unpaid before making new deliveries. This is however the only countermeasure to payment risk Aho has seen to be needed.

The ugly face of bureaucracy has also revealed itself to Aho in Poland. The company requires a special manufacturing certificate by which Aho assures that all the components are manufactured by Aho. This does not however rule out the use of subcontractors by Aho, it merely ensures that Aho takes full responsibility of the quality of the delivered components. Aho also need a permit from Poland before they can hand over their delivery to the carrier.

However, in Aho these features are seen as rather small nuisances. Although exporting to Poland requires somewhat more resources than dealing with the domestic customers, they seem to be rather pleased to this cooperation.

#### ***6.2.4 Evaluating Aho as an exporter and the future of exporting for the company***

It seems that most of the observations made on Merimet could be used to describe Aho as well. The value of exports only count for approximately 5-10 % of Aho's turnover, so exporting is not a crucial activity for the company. Furthermore, Aho did not have to put any effort in initiating the current export operations, as they were first contacted from the foreign companies.

Aho only gathered unofficial information on the Polish market and customer from acquaintances in the Finnish company, even though the Polish company's website was visited in order to get some idea of the potential customer. No official data or information was gathered, nor did Aho seek for assistance in initiating exports.

Aho is a rather active marketer on the domestic market: they seek for new customers, participate in trade fairs etc. However they do not practise any kind of export marketing. As do most companies, Aho also aims to grow. But so far it is seen that the growth can be, and is gained from domestic customers without the need of expanding activities

beyond the Finnish borders. They do not intend to change this strategy any time soon. As Mr Sjöblom puts it: “Aho has traditionally been a company that concentrates on Finland”.

Aho is the only one of the three case companies that is run by an owner-manager in the word’s true meaning. Albaum et al. (2002, 48) mention managerial urge as one of the export motives of companies. It could be said that there is little or none of this present in Aho, as the owner-manager sees domestic markets as the best way to seek growth. And possibly him lacking language skills also restrains the enthusiasm to actively search for foreign customers.

As in Merimet, Aho’s limited export orientation does not seem to be caused by lack of know-how, but rather by the lack of interest to internationalize. Mr Sjöblom has good understanding and past experience on exporting. But he has limited time to spend on foreign affairs. As Aho has no export department or person that would only be responsible of foreign operations, the organization should definitely be strengthened in order to participate more actively in export marketing. Mr Sjöblom agrees with this. He sees that in order to raise the level of commitment to exporting, more should be known of the host countries etc. As for now, he sees that the only way to initiate new export operations would be that a foreign company contacted Aho. However he would welcome also foreign new customers, and says that “of course we sell if someone asks”.

Although some additions to the organization should be made in order to increase exporting, the basic conditions for foreign trade do exist. All of the clerical employees (except the manager) speak English, and used software allows all documents to be printed in English. And even though most of the white-collar people have technical background, they are educated and certainly capable of taking care of foreign customers as well.

Not so surprisingly the future expectations of Aho do not differ much from those of Merimet. The possibility for wider export operations is not ruled out, but it is only seen necessary in the case that domestic economy and sales would start to decrease. At least Mr Sjöblom seems to know what should be done in order to further internationalize the business, but so far it is seem unnecessary. But if Aho some day decides to invest more on the foreign markets, they will face the same challenge than Merimet. Aho has no own products as it manufactures the components that are ordered. Hence it would have to make the most of marketing its machining and processing capabilities, which however do not have to be ashamed of.

In the near future it is actually more probable for the meaning of exports to Aho to decrease. As the deal the Finnish company made to Poland only covers a limited amount of vehicles, at least the orders resulting from this particular contract will seize. However, this same Finnish company is highly active on the international markets and especially on the emerging markets. Possible new deals to new host countries would

open up great possibilities for Aho, but only if Aho is willing to benefit from these opportunities.

### **6.3 Hankintatukku Oy**

The last case company to be scrutinized in this report is Hankintatukku Oy. This enterprise, officially Hankintatukku Arno Latvus Oy, was established on 1982 by Arno Latvus and Aino Niskanen. The establishers are still closely connected to the company. In addition to both owning a share of the company, Mr Latvus is the CEO of Hankintatukku while Mrs Niskanen acts as the chairman of the board. The initial business idea was to manufacture and sell selenium pills as the Finnish soil is poor on selenium.

In 1983 the company moved its production to Karkkila and in 1985 it was granted the right to operate as a pharmaceutical company. At this time, the company was also manufacturing products for agriculture. These were however separated from the other product portfolio already in 1988 and a new independent company, Biofarm Oy, was established to produce and sell products for agricultural purposes.

Today, Hankintatukku concentrates on producing, marketing and selling natural and pharmaceutical products. It employs 65 persons and runs an annual turnover of around 14 M€ Its product portfolio consists of approximately 350 individual products, of which obviously most are variations of the same original product.

#### **6.3.1 *Export operations – past and present***

First export operation of Hankintatukku was initiated already as soon as 1985, when products were started to export to Sweden. Hankintatukku could be seen to fulfil the description of a *born global* by Hollensen (2001, 66): a small, technology-oriented company managed by entrepreneurial visionaries. Back then exports accounted for roughly half of the turnover. Even though back then among these exports were products that today are produced by Biofarm, exports have been a part of Hankintatukku's business since the early days of its existence.

At the moment, Hankintatukku exports to all continents and altogether 51 countries. In these countries it has over 90 foreign customers. These 51 countries include all European countries (excluding France), Canada, USA, Venezuela, México, Singapore, Malaysia, Thailand, Vietnam and Bangladesh.

Hankintatukku has gained contacts in these countries from various sources. Many of them are results from attaining international pharmaceutical fairs. Mexico and

Singapore joined Hankintatukku's network through Finpro's projects, invitation to submit tenders to Malaysia was received after the customer wandered to Hankintatukku's website and the Vietnamese customer became aware of Hankintatukku's products through a weekly magazine program where these products are discussed on Thai television. This TV-show mentioned is produced by Hankintatukku's customer in Thailand.

As the used export mode, Hankintatukku has selected in all cases direct exporting. Hankintatukku's customers are wholesalers, retailers and importers. These customers are responsible for marketing and selling the products in the host countries, and Hankintatukku does not have these functions or business units abroad. Most of the goods sold to more distant market areas are delivered by airfreight. Although the shipments are sometimes rather large in size, this causes only a cost around 5 % of the sales price according to Mr Kaarlas, the export director of Hankintatukku.

As marketing incentives abroad, Hankintatukku does offer e.g. lecturers to be flown to give information on the products to consumers and for example important customers are also every now and then offered excursions to Finland as a reward.

If an operation is initiated in a new host country, usually a contract is made where goals, quantity- or value based, for delivered goods are set. If the new customer does not get even close to fulfilling these limits, Hankintatukku reserves the right to start offering their products to others in the same host country. Prices were before set in dollars or e.g. Swiss francs; nowadays all prices are quoted in euros.

Hankintatukku has negotiated the terms of the contracts used directly with the ordering customers. Furthermore, representatives of Hankintatukku have met most of the foreign customers so they have good understanding with whom they are doing business with.

The past and rejected export operations include at least Brazil and Myanmar. As the underlying reasons are so closely entwined to the challenges of doing business in emerging economies in general, they will be more thoroughly presented in chapter 6.3.3.

### **6.3.2 *Competitive advantages in exporting to emerging markets***

One competitive advantage Mr Kaarlas sees Hankintatukku to possess is simply their location. He has the impression after 20 years of experience on exporting, that products from the Nordic countries are seen to be of high quality and pure. This is partially due to that the officials in the Nordic countries are perceived to be very strict and uncorrupted.

Another clear competitive advantage of Hankintatukku is their marketing strategy in which all resources spent on e.g. advertising are directed to the domestic market. In foreign markets, the customers are responsible for marketing the products to consumers. Hence Hankintatukku can keep the export pricing to customers at a competitive level, and still make a lucrative profit.

Hankintatukku also uses its flexibility as an SME in a couple of ways to its advantage. Firstly they use price differentiation, i.e. products are sold to countries on different levels of economic development by different prices. This means that a customer in Germany pays more than a customer in Czech Republic, who in turn pays more than a customer in Bangladesh.

Secondly, Hankintatukku offers various modifications of its products. The percentages of certain vitamins or other ingredients may differ according to the customer's wishes. Also different kinds of packing are available. And to some customers, products are delivered without labels so that the customer can label them himself.

Among the three case companies of this research, Hankintatukku has the strongest organization to support the export function. Thus it is understandable that they are more eager to negotiate on prices and other terms than the other two companies presented in this study. Even though having an actual export department seems to be a luxury for an SME, the organization is still very light in the sense that the export director is directly in contact with the customers and has high authority to negotiate on terms the customers wish to discuss or change.

However, it should be mentioned that the quantities produced have little effect on Hankintatukku's cost of production. Hence even large quantities purchased do not automatically entitle to lower prices.

The use of experts and assistance has surely offered competitive advantage to Hankintatukku, at least over other international enterprises. Hankintatukku used Finpro's services successfully in México and Singapore. In these countries, the local Finpro representative visited companies and distributed information on Hankintatukku's products. Once enough interested potential customers were reached, Hankintatukku send an own representative to market these products. Although this service costs, new customers were acquired. A similar process is ongoing at the moment in France, although through a local equivalent to Finpro.

Hankintatukku has also applied for and received substitutes for export operations. This money has been used for sales trips and to cover the costs of participating to foreign trade fairs etc. Although it may take up to two years to receive these subsidies, Mr Kaarlas says that they have been of a great help to the company.

### 6.3.3 *Challenges faced on emerging markets*

As Hankintatukku has such wide range of ongoing export operations, it is quite natural they have also encountered several challenges in the way. First could be mentioned the problems they have had with receiving payment and dealing with foreign currencies.

Hankintatukku requires prepayment from new foreign customers. This is not required from new domestic customers, but this is partially due to the fact that the value of the single shipments to Finland is far lower than those delivered to foreign countries. And after some time when the relationship with the customer becomes more solid, prepayment is no longer required from foreign customers either.

Still, Hankintatukku has encountered problems. Once a long-standing customer from Russia announced that it could not come up with the money to pay for the already delivered goods and 200 000 FIM (roughly 35 000 €) were lost. However, this company is still a customer of Hankintatukku's, and the credit loss is collected little at a time by keeping the prices for this customer somewhat higher.

The same incident happened with a Turkish customer not long ago. This time so large amount of money is in question that Hankintatukku decided to collect the payment by means of legal proceedings. A Turkish attorney was hired through an acquaintance who has worked in the Finnish embassy in Turkey. It is however impossible to predict what will happen as the process is in such an early stage.

Having to remind of due payments is a common feature with many customers. However, Mr Kaarlas wants to point out that this is not solely a problem with customers on emerging markets, but getting payment from e.g. Italian customers can sometimes require hard work as well.

Also the fluctuation of exchange rates caused difficulties before. Now this has been amended by using only euros as medium of exchange. Also the customers, even from North America, seem happy with this solution. Obviously this only eliminates the risk of Hankintatukku. It does not erase the fact that smaller currencies tend to be vulnerable to fluctuations. Hankintatukku received contacts from Brazil, and after marketing and negotiating three new customers were found. But in less than six months, the value of the Brazilian real had dropped to the extent that even though Hankintatukku offered generous discounts to their Brazilian partners, consumers in Brazil would have not still afforded to buy Hankintatukku's products. As the labour costs in Finland are so high, Hankintatukku could not lower the price enough to be able to penetrate the Brazilian market.

As Hankintatukku exports pharmaceutical products, they are often in contact with the authorities in the host countries. Getting e.g. their products registered in a new country can sometimes be troublesome. For example in Malaysia, it takes 4-5 years to get a new drug approved. However, Hankintatukku's customer has made most of the work as

Hankintatukku has merely delivered required documents and certificates etc. Now the process is almost completed, and at least Mr Kaarlas thinks it will be worth the wait and effort, as significant orders are expected to be received from the Malaysian customer once the product is registered.

Especially in the East-European countries Hankintatukku has encountered situations where the local laboratories simply can not evaluate the products reliably. The locals get entirely different results on certain quantities for example than the ones measured in several laboratories in Finland. This combined to the post-soviet attitude of the public officials can make Eastern Europe a rather nerve-shattering target market for the exporter. For example, the Czech authorities decided that one of the natural products exported to Czech Republic by Hankintatukku should be considered as being cognac. Half year's struggle with bureaucracy and statements from Finnish, American and EU officials was not enough to convince the Czech customs, and the customer had to pay a heavy alcohol tax on the delivered products.

However, also in this case Mr Kaarlas reminds that everything does not go always that smoothly in the developed countries either. Some time ago, Hankintatukku wanted to register one of their products in Sweden and start to export it to their customer. The Swedish law stipulates that these registrations may not take over 270 days to process. However, due to the unwillingness of the Swedish authority to cooperate this process took six years.

Hankintatukku has also encountered pure corruption. Mr Kaarlas mentions Russia and China as examples of countries where unethical business practises are quite common. Although Hankintatukku's customers occasionally complain that they have been forced to bribe officials in order to get the ordered goods moving, Mr Kaarlas denies Hankintatukku ever taking part of bribery. And as far as China is concerned, the situation improved dramatically a few years back as the entire bureau responsible for granting licences to pharmaceutical products was convicted to prison for taking part in corruption. After this the deliveries of Hankintatukku to China have reached the customer rather smoothly.

Furthermore, it is not only the public officials that wish to gain advantage through corrupt methods. Also some customers have suggested Hankintatukku unethical business practises, e.g. the use of multiple invoices in order to avoid paying taxes in full.

Hankintatukku has also encountered political trade barriers. Not long ago, they already had an interested customer from Myanmar. However, Hankintatukku found out when arranging the first delivery that Myanmar is boycotted and no letters of credit would be issued to Myanmar within the European Union. The only option to do business would have been to arrange payments through a certain Asian bank.

Hankintatukku saw that this would become too complicated and decided to abandon this otherwise rather lucrative export operation.

#### ***6.3.4 Evaluating Hankintatukku as an exporter and the future of exporting for the company***

The level of significance of exporting to Hankintatukku is at a completely different level than it is for Merimet or Aho. At an annual level exports count for 30 – 35 % of the turnover. The company has a separate export department to take care of foreign sales.

Hankintatukku is also the only one of the case companies that produces consumer goods. This certainly has had some effect to the meaning of exports as well. As the representatives of the industrial subcontractors praised the open opportunities on the domestic market, Mr Kaarlas mentioned that Finland is a small country with a highly limited market and further growth will almost inevitably have to be searched for elsewhere.

Hankintatukku is the only one of the case companies to do active export marketing by e.g. participating fairs in Europe, Asia and Middle East. Mr Kaarlas sees that these fairs are great sources of contacts, and he has several new customers from new host countries to prove him right. And although before initiating a new export operation little information of the target market is acquired, Hankintatukku asks for the customer to find out the local regulations and laws that could concern Hankintatukku's products. Although a lot of work is needed to obtain new foreign customers (Mr Kaarlas evaluates that out of 20 contacts one new customer is obtained) Hankintatukku sees this clearly worth the effort.

Exporting is an appreciated function in Hankintatukku, and many good things are seen to result from it. It is seen to enforce the company's status on the domestic market as well, as it improves the company's image and increases volumes produced. In addition, exports can smooth the fluctuations of the domestic market. Exporting is also seen as a form of benchmarking by Mr Kaarlas, he is confident that new ideas can be gained by visiting the customers in host countries and thus seeing how other actors on the industry are doing their business.

However, Mr Kaarlas also warns of over enthusiasm. Even though Hankintatukku's management wishes to see high levels of growth, it also has its dangers. Rapid growth binds capital, and growth should rather be sought by selling more to existing customers instead of acquiring many new customers. Mr Kaarlas sees that even though it would seem representing to be able to report high export volumes, levels of export exceeding 50 % of the total turnover are risky for the company.

However, he admits that the maximum level of sales on the domestic market is soon reached. And if after that the management and owners of the company still aspire for more growth, there are not many options left but to turn eyes even closely to the international markets. But for Hankintatukku this should not be a problem. With their experience, organization and networks widening their export operations should not prove to be an insuperable obstacle.

## 7 CONCLUSIONS

In this seventh chapter, the research findings to all these research questions scrutinized will be addressed in the same order as the questions are presented in the preceding list. As the case companies were already studied more closely individually in the preceding chapter, here a more general level approach will be used. The research problems initially set were:

1. What kind of operations do SMEs have in emerging market areas and why have emerging markets been targeted?
2. What advantages do SMEs possess in exporting to emerging markets?
3. What are the main challenges SMEs face on emerging markets and how do they overcome them?

Two out of the three case companies, both of them small industrial subcontractors had only limited export operations, meaning exports accounting for a maximum of 10 % of revenues generated through foreign trade. The third, the only one producing customer goods i.e. pharmaceutical and natural products, was however far more closely involved in exporting.

All of these have operations on emerging markets, and to all of them, exports to emerging markets accounted for a significant portion of the export revenues. As for the industrial companies, Eastern Europe seemed as an important market area. The third company was however active on all continents. By the standards of Cateora and Ghauri (2000, 16-17), Merimet and Aho could be seen to be in the *infrequent foreign marketing* and Hankintatukku in the *regular foreign marketing* phase of the international foreign marketing involvement.

None of the three case companies had made FDI on emerging markets, i.e. they had no activities on the soil of the host country and all activities were led and operated from the home country. This finding suggests that the SMEs are reluctant to make large-scale investments on foreign target market, and rather avoid risks by using less risky export modes as indirect and direct exporting. Even the pharmaceutical company that had long experience on exporting did not want to “embark” on foreign markets and rather uses intermediaries to retail and market its products. This no surprise regarding the fact that all of the case companies seemed rather reluctant to increase the importance of exports for their business. E.g. Woods (2001, 204) mention that the desired speed of market entry is a significant factor in a company’s choice of market entry route.

As the underlying theory on SME internationalization suggests, the clearest competitive advantage of the studied companies in exporting is their flexibility. They can adapt to almost anything, thus helping their customer to develop processes and products. The contracts are rather loose in nature, and do not obligate the customers to e.g. buy a certain amount of given products. According to Hollensen (2001, 321), this is

especially crucial for the two subcontractors as modern companies are developing their purchasing functions to be more effective. Hollensen (ibid.) sees that companies tend to reduce the number of subcontractors and strengthen their relationship with the remaining suppliers, but demand higher quality and efficiency from them.

Also the small organization in the SMEs eases the cooperation. As in two out of three cases, there is one single person who is responsible for the export operation, negotiating on changes etc. does not seem to be overcomplicated. In the third company, there are three persons responsible of exporting. This does not seem as a mentionable more bureaucratic organization than the other two. And for example Carson et al. (1995, 43) see that it is highly important in terms of relationship marketing that there are people who are clearly designated to be the customers' contact persons as this signals flexibility and efficiency.

As for all three case companies, the high quality of products seems to be a clear competitive advantage. This was also expressed by the representatives of all the three companies. These SMEs also offer high level of differentiation to their customers. The two industrial engineering companies do not even have any own products, as they only produce components according to their customers' drawings.

As for the challenges of SMEs on emerging markets, quite similar results were received. All companies had faced some level of difficulties in getting payment from their customers in emerging economies. Also all had somewhat faced the necessity to do more paperwork or struggle with higher levels of bureaucracy when doing business on an emerging market.

All three companies use rather same kinds of countermeasures to prevent credit losses from occurring, and only one company had actually faced incidents where the payment was never received. One of the case companies have also had same kinds of problems with customers from developed countries.

If the data gathered from the case companies is somewhat interpreted, it could be said that all of them have faced some levels of employee incompetence in the developing economies. This incompetence occurs in confusions, unnecessary orders and their cancelling etc. It causes for the exporting SMEs working hours to be lost in unproductive work.

For the two industrial companies, one common element that presents a huge challenge is the insufficiency of resources allocated to exporting. Although this is not a challenge affecting solely the export operations on emerging markets, it should be mentioned as it almost entirely prevents the development of the export function. The people assigned to be responsible for exporting try to manage and fit the export-related tasks somewhere in between their actual work. Although they are surely doing a good job now, they have little possibilities of developing the exporting function.

As for the pharmaceutical company, their wider export operations had led them to far more challenges. They had faced both corruption and political trade barriers. Furthermore their products require in many countries licences to be sold. Hence, bureaucracy was even more familiar to them.

All in all, every company had mostly good things to say about their export operations. Still especially the industrial subcontractors were reluctant to change their strategy in a more export-oriented way. This is due to the good economic situation the industrial sector of Finland is right now. Additional sales can rather easily be found from domestic markets without the need to initiate new export operations, which again are perceived to be somewhat risky in nature. Even the third company studied with extensive foreign customer network was somewhat reluctant to search for new customers abroad as the risks are seen to be higher than in doing business in the home country.

However, all of the companies mention that if the domestic market starts to deteriorate or the market becomes saturated, growth can be sought for from foreign markets. Still this at least to some extent seen as a solution of last resort.

Several theories and models on the internationalization process have been created by highly capable persons (e.g. Ahokangas & Pihkala 2002). However, for example Hollensen (2001, 321-322) criticizes these theories somewhat, as most of them are based on the idea that there is deterministic force that drives companies to internationalize. Hollensen (ibid.) sees that especially when talking about subcontractors, the strategies of their partners have crucial effect on the internationalization process. Evidence from this could be seen from the activities of the subcontracting case companies in this study, as they have only initiated foreign operations in the footsteps of their important customers.

Finally it could be said that this research merely scratched the surface of this topic. This could however be considered as a good starting point for additional research. Consequential studies could e.g. concentrate on only one of the initial research questions of this study. For example the challenges on emerging markets and how do SMEs perceive and overcome them would probably give valuable insight on SME internationalization.

It is quite likely that at least the amount and scope of SME operations on emerging markets will not decrease. Hence it would be important to understand this phenomenon better. This could also give new entrants valuable information of the emerging markets, and perhaps even lessen the fear of initiating export operations in the developing economies.

## 8 SUMMARY

Emerging markets and the small- and medium-sized enterprises are both rather trendy topics right now. Still very few researches have so far aimed to connect these two concepts, i.e. what, where, how and why are the SMEs operating on the emerging markets.

This study aimed to unite these theories and assess the operations of SMEs on emerging markets. The main research problem was set to be: *“What are the main advantages and challenges of SMEs in exporting to emerging markets?”* This research problem was further divided into three sub problems:

4. What kind of operations do SMEs have in emerging market areas and why have emerging markets been targeted?
5. What advantages do SMEs possess in exporting to emerging markets?
6. What are the main challenges SMEs face on emerging markets and how do they overcome them?

Chapter 1 introduced this research and its purpose as a whole. A justification for why this sort of study is needed was sought. This justification can be found from statistics: the role of Finnish SMEs in exporting is growing, as is the meaning of the developing export markets for the Finnish companies. In addition, the concept of SMEs was briefly introduced.

The following three chapters were purely theoretical. First, the concept of emerging markets was closely scrutinized in chapter 2. This chapter presented ways to evaluate the level of economic development of a nation, along with commonly used terms and concepts referring to the level of economic development. In fact, the entire chapter focused on making clear the concept of emerging markets and how it is understood in this study. An important tool for this was the Trade and Development Index (TDI) which is used by the United Nations. One elemental advantages of this index is that it sees far beyond the purely economic indicators, and also takes into account such themes as human rights and environmental issues.

The third chapter focused on the internationalization of SMEs. This chapter presented the most important advantages of SMEs, along with the most common challenges the smaller companies may face in their way to international markets. The undisputable advantages of SMEs mainly consist of characteristics generated by their flexibility and low level of bureaucracy, while the most common challenges are lack of financial resources and export marketing know-how.

Chapter 4 dwelled more deeply into assessing emerging markets as target markets for SME internationalization. The main finding of this chapter was that emerging markets offer great possibilities but, on the other hand, can be a challenging target for the exporting company. High levels of growth and unsatisfied demand seem lucrative for

the international companies. However, many risks have to be taken into account. These include at least weak infrastructure, currency risk and high levels of bureaucracy, crime and corruption.

The fifth chapter presented the research design for the empirical part of this study. Qualitative methods were chosen to be used, and sources for empirical data were selected. The empirical data were collected through theme interviews, and these interviews were conducted in three Finnish companies in spring 2008. These case companies, Hitsaus- ja rakennustyö Aho Oy, Merimet Oy and Hankintatukku Oy were also presented in chapter 5. These companies consisted of two industrial subcontractors and one pharmaceutical company.

In chapter 6, the research findings from the theme interviews were presented. All the case companies were evaluated individually. The motives of internationalization for these companies seemed to be rather push-oriented, as the international markets were mostly seen as a back-up plan for situations where the domestic trade was weakening.

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### **Interviews:**

Arno Sjöblom, production manager, Hitsaus- ja rakennustyö Aho Oy. Interview 18.3.2008. (37 min)

Matti Kaarlas, export director, Hankintatukku Oy. Interview 26.3.2008. (56 min)

Matti Riihimäki, logistics engineer, Merimet Oy. Interview 17.3.2008. (45 min)

## APPENDIX 1      Framework for the theme interviews

### **BACKGROUND INFORMATION**

- Company
  - Industry
  - Number of employees
  - Year of foundation
  - Year of first export operations
  - Host countries
  - Importance of exporting to the company
- Interviewee
  - Employment age
  - Title
  - Role in making exporting decisions

### **TOPICS FOR INTERVIEW**

- Exported products and used export modes
- Has the company gathered market information and how
- Why the current host countries have been selected
- Has the company received funding or assistance and if, from where
- Challenges in exporting
- Rejected or abandoned export operations à reasons
- The future role of exports for the company
- Other themes that come up during the interview

## APPENDIX 2 Comparison chart of the interviews

	<b>Merimet</b>	<b>Aho</b>	<b>Hankintatukku</b>
<b>Interviewee</b>	Matti Riihimäki	Arno Sjöblom	Matti Kaarlas
<b>Title</b>	Logistics engineer	Production manager	Export director
<b>Interviewee's role in daily export routines</b>	Orders, deliveries	Orders, deliveries	Supervisor
<b>Interviewee's role in making exporting decisions</b>	Consultative	A member in the decision-making process	Decision-maker
<b>Date of interview</b>	17.3.2008	18.3.2008	26.3.2008
<b>Dur. of interview</b>	45 min.	37 min.	56 min.
<b>Interview conducted according to the script</b>	Yes	Yes	Yes
<b>Additional information sources</b>	Company website	Company website	Company website
<b>Additional information received from interviewee after the interview</b>	None requested nor received	None requested nor received	None requested nor received
<b>Additional presentation provided by the interviewee</b>	Presentation of company's premises and products	None	Presentation of company's products