Prometheus, Vol. 25, No. 3, September 2007

The Internationalisation of the Small and Medium-sized Firm[1]

JORGE RODRIGUEZ

ABSTRACT *In the last few decades, SMEs have become increasingly active in international markets. SMEs do not necessarily follow a pattern of incremental internationalisation as they have a wide range of options and many are opportunistic. A large postal survey was conducted in five countries—the UK, France, Finland, Australia and Mexico. Many similarities in internationalisation strategy were found among these companies.*

Keywords: born global; internationalisation strategies; outward and inward international activity; SMEs.

World Trade during the 1990s

International trade has grown steadily since World War II, but has been particularly strong since the new wave of internationalisation of the 1980s and 1990s. The World Trade Organization reports growth of about 7% per annum in volume terms in world trade during the 1990s.[2] Internationalisation has also been characterised by greater economic integration through the formation of regional trade blocs, such as NAFTA, APEC and the European Union. Foreign direct investment (FDI) increased significantly during the 1980s and 1990s. About two-thirds of total FDI flow was between North America, Europe and Asia (the Triad), and only about one-third of FDI was directed to developing countries.[3]

The near monopoly of large firms in international trade has been challenged during the last two decades. New opportunities have arisen for small and medium-sized enterprises wanting to engage directly or indirectly in international businesses. SMEs derived advantages from increasing international trade in products and services, the downsizing and outsourcing activities of large companies, better transportation systems, the expansion of financial services, inexpensive international flights, the wide adoption of ICT, and the use of English as the international language of business.[4]

Prometheus ISSN 0810-9028 print/ISSN 1470-1030 online © 2007 Taylor & Francis
http://www.informaworld.com/journals
DOI: 10.1080/08109020701531411

In the United States, SMEs contribute about 30% of total exports.[5] SMEs from OECD countries contribute between 25% and 35% of the world's manufactured exports.[6] SMEs from APEC economies produce about 30% of direct exports.[7] In the European Union, 18% of all SMEs export; however, the most common form of internationalisation for 30% of them is importing from foreign suppliers.[8] According to an OECD study,[9] more than three-quarters of SMEs are already affected by the growing trend towards internationalisation. The number of companies focusing their activities solely on the domestic market, and that have previously been unaffected by this process, keeps decreasing. The European Commission considers the 'non-internationalised' companies as a 'residual' group of SMEs.[10]

Internationalisation Entry Mode

Most of the literature on the internationalisation of trade activities has been focused on the strategy followed by large multinational corporations.[11] There are two main theories. The first states that internationalisation is a sequential, gradual and evolutionary process. It may be described as a stepwise process of increasing involvement and commitment with overseas markets.[12] The second theory, or rather group of theories as there is not one but a series of them, states that the whole process of internationalisation is changing. Companies may start overseas activities in a shortened period of time, either by-passing or leaping over some or all of the logical steps of increasing foreign market commitment.[13] The Internet and e-commerce have opened new opportunities that go beyond the consideration of some traditional theories of internationalisation.[14]

The Step-by-Step Approach to Internationalisation

Large companies got to know their home market before they ventured abroad. They usually followed the same lengthy step-by-step process: first, they gained access to local markets, and after that, moved to regional and national markets. Once they consolidated their position in their home markets, they looked for opportunities to export. Some of the first studies on the internationalisation of large firms came from the University of Uppsala in Sweden.[15] The Uppsala model was based originally on the study of the internationalisation of overseas markets by large Nordic manufacturing firms (initially most of them Swedish) that developed their international operations following a step-by-step approach targeting neighbouring countries.[16]

The Uppsala model has two underlying assumptions. First, firms became interested in overseas markets to continue growth because the home market had become unprofitable. They usually entered new markets through exports and only years later set up manufacturing operations in the target country.[17] Second, in order to reduce uncertainty, these firms preferred to initiate export activities to countries with similar languages and cultures, and thus reduced levels of psychic distance.

> The psychic distance is defined as the sum of factors preventing the flow of information from and to the market. Examples are differences in language, education, business practices, culture and industrial development.[18]

Once the company had gained international experience, it would set its eyes on international markets that are psychically distant.[19] The last stage is the international company with holistic strategies and overseas partnerships transcending cultural differences. This type of company follows international trends and conditions, exploiting them to its advantage. However, it may be argued that this model just reinforces the popular belief that companies should grow and become bigger in this step-by-step process. In this lengthy model of increasing internationalisation based on large firms, it seems there is little room for small and medium-sized firms.

Other Theories of Internationalisation

A new approach was needed to try to explain the different strategies followed by companies of all sizes, and particularly SMEs, in the internationalisation of their activities. However, there is no single theory that captures the variety of options for internationalisation. The means by which companies enter overseas markets are not mutually exclusive; in fact, they are generally combined.[20] There are companies that follow a low-risk approach, preferring to use local operators that are familiar with the target market that may act as licensees or distributors. However, depending on the market results, these companies may decide to switch the operation mode, perhaps by creating an overseas production plant.[21] The international strategy of other companies may evolve toward strategic alliances with overseas companies. SMEs have limited material and human resources; therefore, an alliance may offer the opportunity to initiate distribution channels, and even the joint development of new products with another company.[22] But, in general, few SMEs ever establish joint ventures abroad as it is a complex type of internationalisation that demands much commitment of time and resources.[23]

Other theories of internationalisation establish that there is a series of push factors in the home market and pull factors in overseas markets that trigger large companies to initiate international activities.[24] Companies may go to overseas markets because they are searching for suppliers of parts and materials, to reduce their costs of production, or to secure markets for their own products.[25] SMEs may initiate international activities because of decreasing market share, increasing domestic competition, or to obtain economies of scale.[26] Strong pull factors coming from overseas may make the company decide to set up its production facilities in some of the countries that have been importing its products. This is more common with large firms than with SMEs.[27] The deciding factor for SMEs to engage in international activities could be a growing overseas market, or an important customer going overseas. A company may also gain an international presence by means of franchising arrangements.

The extreme case of internationalisation is the so-called ‘born global’ companies. They are created specifically to exploit an international opportunity without undergoing a process of increasing commitment to overseas markets.[28] Other authors detect ‘born-again global’ companies, companies that have had no international activities, but suddenly change their strategy for total dedication to international markets.[29] Born global companies are SMEs that have targeted an overseas niche market, taking advantage of a unique product or service, which is usually knowledge-based.

SMEs do not often have a strategic plan to become international; they are reactive to opportunities that come by chance and many do not have a long-term commitment to overseas markets.[30] A weakness of the incremental internationalisation models is that they do not always reflect the fast-moving nature of the internationalisation of the small and medium-sized firm. Many SMEs are opportunistic and move in and out of overseas markets, depending on circumstances.[31] The first international contact for most SMEs is not through exports, but through a direct or indirect foreign supplier.[32] SMEs that have a mid-term perspective may use inward experience to prepare for future outward activity using the links formed with international suppliers.[33] SMEs may become international by linking outward with inward activities. A holistic approach is needed to capture the great variety of international options that are opened.[34]

Methodology

The results presented in this paper on the early and rapid internationalisation of the firm are part of a larger study on the internationalisation of the small and medium-sized enterprise from the perspective of the SME manager. The empirical work was carried out in five countries—the UK, France, Finland, Australia and Mexico. There are several reasons for selecting this diverse group. Of the five, the UK and France are developed countries with large domestic markets and about the same population size. On the other hand, Finland and Australia, also developed countries, have small populations, especially Finland. Small domestic markets force Finnish and Australian companies to look for international markets. Australian companies are also geographically isolated. The fifth country, Mexico, is a large developing country that opened her economy in the 1980s and now has significant international activity. Mexican SMEs are usually not part of international studies. Therefore, this study brings a probably fresher, wider and more inclusive perspective to the internationalisation of SMEs.

Research Design

The first part of this research was conducted in Mexico. This phase consisted of a series of semi-structured, face-to-face interviews with academics and experts in SMEs from several universities, experts in international trade, policy makers and government officials. The interviews helped to reveal some of the main factors in the internationalisation process of SMEs and established the background scenario for the work. The same questionnaire was used in each of the five countries. The layout and the answer options—although in four different languages—were not changed at all. The cover letter, questionnaire and reminder letters were all translated using the final English version as the basic reference. Native speakers carried out translation of these documents into French, Finnish and Spanish. In each case, a different person did the back translation, which was then compared with the original document to make sure that the original meaning had not been lost in translation.

Selection Sample Criteria

The European Union defines a SME in terms of full-time employees; that is, a company that has fewer than 250 but more than 10 employees, and this was the definition used in the survey. In each of the five countries, 500 small and medium-sized companies were selected. This was considered to be a large enough sample to provide an adequate number of usable responses. The response rate in SME surveys is generally low.

Any survey of SMEs faces the problem of obtaining reliable databases. It was decided to use the services of a UK-based commercial company selling international trade directories. These were used for the Australian, French and British surveys. A different strategy had to be employed for the Finnish and Mexican surveys as the commercial company did not cover these countries. In Mexico, the database came through chambers of commerce and industrial associations. In Finland, the database was obtained from the Federation of Finnish Enterprises. The survey was conducted from July 2003 to February 2004. There were 550 questionnaires received for a general response rate of 22%. Responses rates were 38% in Finland, 21% in Mexico, 20% in Australia, 18% in the UK, and only 12% in France.

Age and International Activity

There is evidence that for many companies the time from start up to initiation of internationalisation has been reduced.[35] This survey revealed that nearly half (44%) of the surveyed companies engage in international activities within five years of creation (Figure 1). Over two-thirds of companies initiated outward or inward trade activities within their first decade.

The average company in this survey is nearly three decades old, which suggests that these companies have accumulated vast experience and are well established. The companies also started international activities in a similar fashion. Inward activities tend to be the first type of international contact for many companies and may lead to outward activities; the manager and the company gain experience and get to know people.[36] Figure 1 shows similar results for all five countries. These results appear to challenge the traditional notion of the lengthy step-by-step internationalisation process. More than half of British and Mexican companies became involved in overseas activities within five years of their creation. A third of Mexican companies became involved in international activities within the second five-year period of existence.

Outward and Inward International Activities of Surveyed Companies

The companies that participated in this survey are extensively engaged in outward and inward international activity; nearly five-sixths of the surveyed companies participate either directly or indirectly. Table 1 gives an overall view of the five-country results. On the left hand of the chart are outward activities originating in

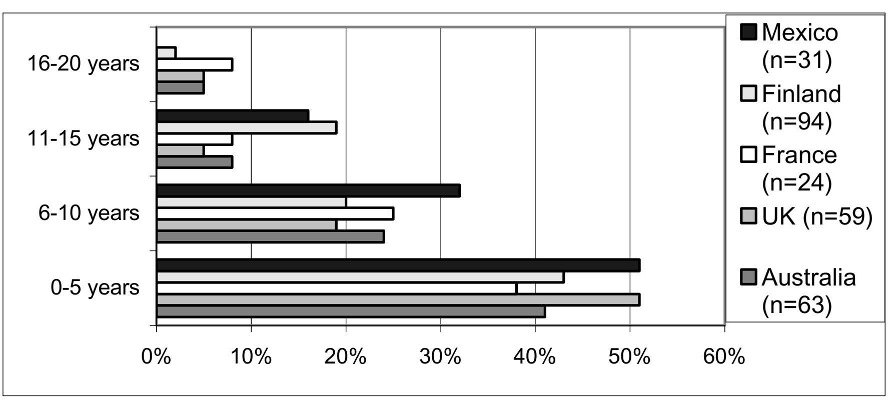


Figure 1. Age of surveyed SMEs when overseas income first received (n=271).

Table 1. Outward and inward direct and indirect international activities of surveyed companies (n=455)

Home country				**Foreign country**			
Outward international activities				**Inward international activities**			
Direct	Basic	Export of products	**38.0%** (173)	Import of products	**62.0%** (282)	Basic	Direct
		Export of services	**19.3%** (88)	Import of services	**11.0%** (50)		
	Advanced	Selling know-how*	**6.4%** (29)	Buying know-how	**5.0%** (23)	Advanced	
		Franchising	**0.2%** (1)	Buying franchises	**0.7%** (3)		
		Commissions and licences	**4.2%** (19)	Commissions and licences	**0.2%** (1)		
Indirect	Export products or services through other companies		**59.1%** (269)	Through other companies	—**		Indirect

Note: Percentages do not add up to 100 because of possible multiple answers, and activities are not mutually exclusive.

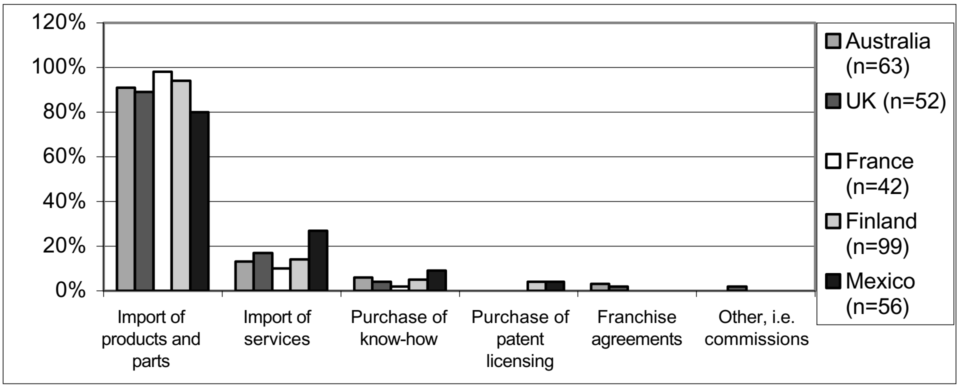
* Know-how activities include the licensing or acquiring of patents.

** This information was not requested in the questionnaire.

the home country, while on the right are inward activities coming from overseas. The activities are arranged by whether they are performed directly by the company or indirectly through a third party. They are further divided according to whether they are basic (that is, activities dependent on the export or import of products or services) or advanced (that is, activities based on the company's exploitation of its intellectual capital).

Inward international activities cover all the activities undertaken by the firm related to the import of products, services and resources from overseas, either directly or indirectly, when seeking to compete in its own domestic market. These imports may be incorporated in the company's products or services for the domestic market or may be later exported.[37] The term also includes international competition in the domestic market.[38] Table 1 shows that nearly three-quarters of surveyed companies buy directly from overseas. The most important activity by far is the import of products or parts (62%) from overseas suppliers, while import of services (11%) does not have the same importance. Inward activities may initiate future outward activities, as the SME manager may select overseas suppliers based on how they may help in the company's international plans. The surveyed SMEs are not very active in more complex forms of advanced inward internationalisation, such as buying know-how. The survey did not ask about the indirect international inward activities of companies, such as importing products or services through domestic agents.

Most literature on the internationalisation of the SME has focused on outward activities. However, more companies in this survey are involved in inward activities than in outward. For most SMEs, inward activities are an introduction to internationalisation.[39] The great majority of SMEs in the five-country survey import products or parts (Figure 2). The strategy followed by SME managers from the five countries is very similar. There are barely any significant discrepancies. The import of services comes a long way behind import of products. The four other inward



Note: Percentages do not add up to 100 because of possible multiple answers.

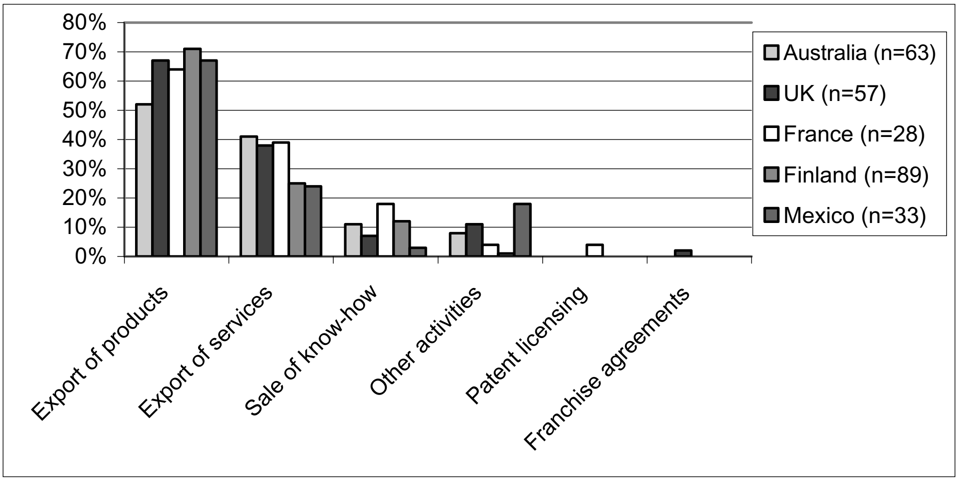
Figure 2. Surveyed SMEs engaged in inward international activities (*n*=312).

international activities, all knowledge-based, are not used very frequently, with the possible exception of the purchase of know-how.

Outward international activities cover all the activities undertaken by the SME to deliver its products or services when seeking to compete in overseas markets.[40] The most basic form of outward international activity is the export of physical products, parts and services either directly or through a supplier to a larger company, or via an intermediary domestic company, such as a wholesale company. There are some more complex forms of outward internationalisation that are more knowledge-based, such as having a licensor or franchisor overseas, or selling know-how. SMEs with foreign direct investment activities are scarce; for example, a European study of SMEs with international activities finds that only 3% report having subsidiaries, branches or joint ventures abroad.[41] A 1997 study by the OECD claims that about 10% of SMEs are engaged in foreign direct investment.[42] In the light of other survey results, this seems generous.

Table 1 shows the number of surveyed SMEs that receive some sort of income through direct basic outward activities. Nearly three-fifths (59%) of surveyed companies are engaged indirectly in international activities. This is the most common form of outward activity among companies. The most frequent direct outward activity is export of products with 38% of firms, while only 19% export services. This finding is in line with a 2004 European Commission study that finds that the manufacturing sector is more likely to have international activities than the service sector, which has been traditionally oriented to domestic markets, although this situation is changing rapidly.[43] SMEs in this survey are not active in the more advanced forms of outward internationalisation. The most important of these activities is selling know-how (about 6%), followed by companies receiving income from commissions or licences (about 4%). Patent licensing and franchising involve only one SME manager each of the five countries surveyed. An earlier OECD study claims 'around 10 to 15 per cent of SMEs have licences, franchises or other arrangements with firms outside their host country'.[44] These percentages appear extremely high, and are not consistent with what was found in this five-country survey, all of them OECD members.

Among the outward international activities of these SMEs, the most common by far is export of products (Figure 3). Export of services is the next most frequent



Note: Percentages do not add up to 100 because of possible multiple answers.

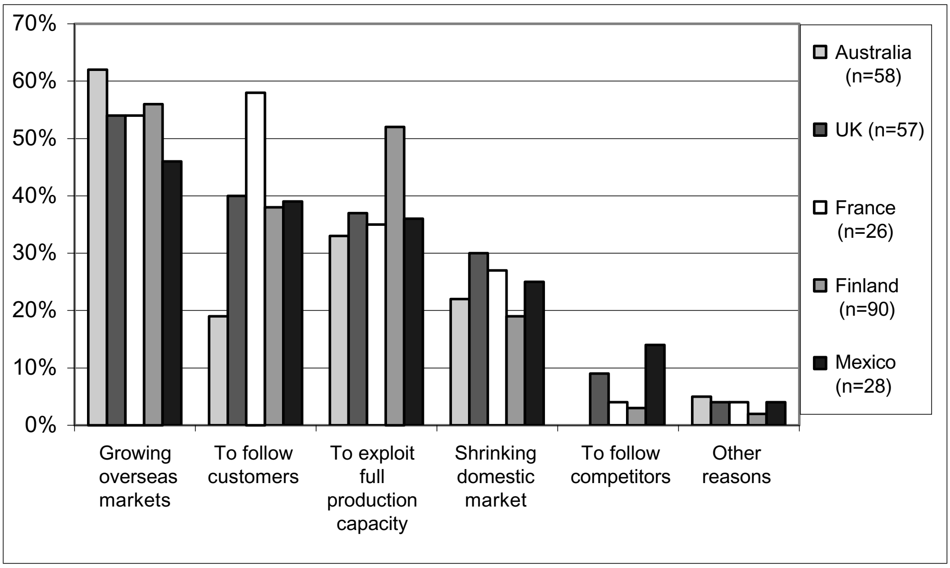
Figure 3. Surveyed SMEs engaged in direct international outward activities by country.

outward activity. The proportion of Australian, British and French companies engaged in export of services is about 40%, whilst Mexican SMEs have a much lower percentage. This may be attributable to a lower level of economic and technological development. Export of services together with export of products may be considered the two most basic international activities. However, there are other more complex activities that are knowledge-based and thus more advanced. Few SMEs engage in these, although knowledge is increasingly becoming an important source of comparative advantage among SMEs with overseas activities.[45]

One example of advanced overseas activities is the sale of know-how. There are large differences amongst the five countries, with French companies being the most active and Mexican companies the least active. SMEs may also receive income from overseas customers from a variety of other services. One British manufacturing SME obtains consultancy fees, an Australian manufacturing SME receives income from a manufacturing licence, and a Mexican SME receives sales commissions for representing foreign producers. One Finnish SME offers a local warranty service to purchasers of well-known household products. A few French SMEs license patents, and a few British companies obtain income from franchise agreements.

Main Reasons for Internationalisation

The manager is the key decision maker in the internationalisation of the SME. Managers engage in overseas activities for different reasons. There are push drivers, internal stimuli at the company or home country level. And there are also pull drivers, external stimuli coming from the target country. The two most common reasons for starting international activity in all five countries are of the pull type. The most frequent is the attraction of growing overseas markets (Figure 4). For some SMEs, having overseas customers gives credibility, not only internationally, but at the domestic level as well.[46] Following customers that go overseas is the



Note: Percentages do not add up to 100 because of possible multiple answers.

Figure 4. Main reasons for starting international activities (*n*=259).

second reason. The customer may demand that the SME go international. However, there are also differences among these countries. French SMEs trade with neighbouring Western European countries, while Australian SMEs trade with Asia. As distances from Australia to Asia are great, it is likely that following customers overseas is not generally part of SME strategy.

The most common push driver is to exploit full production capacity. Finnish managers referred to this reason most frequently, probably because of their small domestic market. The second most frequent push driver is a shrinking domestic market. SME managers probably want to escape from mature markets and from increasing competition at home.

> For our products in engineering, higher prices can be obtained in the US than in Western Europe, but there is still a market in both places. [However] the UK market is shrinking very fast! (UK manager of a company making machine devices.)

Some SMEs adopt a niche strategy to compete against larger companies that offer mass produced products. But even these companies are under assault, as they have to compete against products coming from developing countries. Perhaps the best example is China. Large companies and SMEs alike are threatened by what has been called the 'China price'. Chinese companies are offering low prices that most domestic companies cannot afford to match.[47]

> The world market is extraordinarily competitive, specially the advent of the (commercially very aggressive/suicidal) Chinese. So we distinguish ourselves by performance (real or perceived), style, support and branding. It is impossible to compete with Asia on price and make a profit! So we price higher,

> but aim to produce special quality products. (UK manager of a manufacturing company.)

Born Global Companies

Born global companies have attracted a lot of attention in the literature on the internationalisation of SMEs.[48] This type of company contradicts the theory of the gradual incremental internationalisation of the company. Born global companies are created specifically with the purpose of seizing an international opportunity.[49]

> Born global is a business organisation that, from or near its founding, seeks superior international business performance from the application of knowledge-based resources to the sale of outputs in multiple countries.[50]

Despite being a favourite research topic, born global companies are still rare. Only about 4% of the companies in this survey can be characterised as born global. The number is too small to try to generalise any of the findings; nevertheless, some of the main characteristics are worth noting. Most of these born global companies are in the service sector. More than half have fewer than 50 employees. They have a much more intensive international activity than the average surveyed company. All the born global companies receive income from overseas, compared with just under half of surveyed companies as a whole (Table 2).

Managers from born global companies are driven by pull factors, exporting mainly services to growing overseas markets. These managers are more educated than the average manager: half of them have university education and over one-third postgraduate qualifications. They speak, on average, two languages, and English is spoken by all. Nearly half of them have lived overseas. This group of managers travels constantly, averaging over 10 international trips annually to visit current or prospective customers and to attend trade exhibitions.

A Mexican born global company

The SME manager of this born global company is a mechanical engineer who undertook postgraduate studies in Japan. After returning to Mexico, he worked in a company owned by a relative, a company supplying electronic parts to the Mexican telecommunications industry. The first international opportunity came when the director of a customer company was transferred to the Brazilian subsidiary of Alcatel, thus offering the SME manager the opportunity to become familiar with international trade. After five years of working for his relative, he decided to become independent, taking advantage of the large network of contacts he had developed among customers and suppliers. The new company was created specifically to exploit an international opportunity to become supplier to a large American company.

Table 2. Exports of born global and other surveyed SMEs

SMEs	Production exported by quantity	Production exported by value
Born global SMEs (n=20)	48.5%	51.9%
Other surveyed SMEs (n=494)	17.7%	19.1%

The company manufactures harnesses (cable assemblies), key elements in the performance of large electronic devices. The harness market is very competitive. However, the manager focused on a niche that demands great variety, low volumes and great technological content. Special harnesses are used in industrial computers and automatic teller machines (ATMs), among other products. The harnesses are tailor-made to the customer's requirements, with the volumes varying from five to 1,000 pieces. The large American company is the only customer in the US, but it allows the Mexican company exports to reach indirectly more than 50 large customers in the American automotive and telecommunications industries. All the company's products are exported through Federal Express, the delivery company, practical because the products are light and occupy low volume. The company has had explosive growth, starting with eight employees and increasing to 40 in only 18 months.

Concluding Thoughts

Most research on the internationalisation of the SME has been interested in their exporting. But companies may also become international through importing. A company that aims to be competitive in the international arena, or that wants to be prepared to face increasing international competition in its domestic market, also needs an international perspective.[51] A more holistic research approach is needed to capture the intensity, complexity and diversity of today's internationalisation process.[52]

The similarities among the small and medium-sized enterprises from the five surveyed countries and their internationalisation strategies easily outweigh their differences. Most literature has focused on the differences, perhaps missing the many similarities. Mexican SMEs are not regularly included in international studies, but their international behaviour is similar to that of their counterparts from the four developed countries in this survey. Born global companies—those companies created specifically to seize an international opportunity—are still the exception rather than the rule. Further work is necessary to explore the significance of previous inward international experience in initiating outward activities. Inward internationalisation may play a more important role in international business than has been acknowledged in the literature.

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