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SME Internationalization, Public Policy and the Growth Agenda

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Introduction

Small- and medium-sized enterprises (SMEs) comprise some 90 per cent of firms in most countries. While the majority have operations limited to their native economy alone, a growing number of SMEs are active in international commerce. SMEs are often the major source of technological innovation, of industrial upgrading and of the opening up of frontiers of new industries. The true extent of their contribution to individual national economies is very considerable and difficult to grasp (Cernat et al. 2014). The widespread decline in barriers to trade and investment associated with the globalization of markets, together with technological advances in communications, is now enabling SMEs to anticipate becoming direct participants in international business soon after establishment (Oviatt and McDougall 2005) so increasing the number of international SMEs.

SMEs represent the fastest-growing cohort of international firms. Over the period 1992–2007, the exports of US SMEs have doubled, and in Japan imports increased 74 per cent and exports increased 62 per cent. Within the European Union (EU), 33 per cent of native SMEs are internationalized (European Commission 2010b). Elsewhere, SMEs account for about one-third of exports from Asia and about a quarter of exports from developed

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countries in the rest of the world, including the USA. In selected countries such as Italy, Ireland and China, SMEs contribute 50 per cent or more of total national exports (Cernat et al. 2014; Hilgers 2009).

International business is a potentially expensive undertaking and requires the firm to deal in foreign languages, cultures and unusual ways of doing business—these are known as the costs, or liability, of foreignness or, more generally, of outsidership (Johanson and Vahlne 1977, 2009; Zaheer 1995). Compared with doing business in the familiar home market, international business is complex and challenging (Johanson and Vahlne 2009), and these bear disproportionately heavily upon SMEs. Compared with leading firms, SMEs not only are characteristically small in size, but also exhibit youth and inexperience, while lacking substantial financial and human resources (Nakos et al. 2014; Wright et al. 2007). For SMEs, there is a fine balance between (international) growth and performance (Sapienza et al. 2006). In particular, management may be either short-handed or deficient in superior business skills, or both. Small size and lower levels of resourcing make SMEs vulnerable per se, for several reasons: they often operate on slim profit margins and across a narrower base of revenue streams (Westhead et al. 2001). And when internationalizing, empirical evidence points to the possibility of an injudiciously heightened level of international commitment by these firms, despite the considerable uncertainty they face—notwithstanding their poor resourcing, inadequate knowledge of the foreign market and scant international experience (Kalinic and Forza 2012). Under such conditions, SME entrepreneurs frequently turn to their networks to overcome the liability of outsidership and base their investment project decisions on the affordable loss principle. They also adopt flexible goals rather than return-on-investment calculations and the detailed business plans that typically are the basis of professionalized business planning (Kalinic et al. 2014).

Yet, for all these firms' frailties, many economies have pinned their hopes of growth upon the SME segment of domestic industry, expecting them to perform the role of a national productive "centre of gravity", as exemplified by *Europe 2020: A Strategy for Smart, Sustainable and Inclusive Growth* (European Commission 2010a). The logic is that SMEs can be presumed to be more firmly rooted in the home economy than might be the case with established, but more footloose, multinational enterprises. But, at the same time, governments recognize that SMEs have to be internationally competitive in order not to be outcompeted within their domestic market.¹ To gain this competi-

¹ For example, see "Think Small First"—A "Small Business Act" for Europe (European Commission 2008) and *Study on Support Services for SMEs in International Business* (European Commission 2013).

tive ability, SMEs need to be able to establish abroad so as to learn how to compete effectively, on the same terms as their peers. Export, foreign direct investment and non-equity-based competition abroad are therefore crucial to the performance of the SME sector, and to income, employment and growth in the home economy. However, how best to design policy for the domestic SME sector in general, and particularly with respect to SME internationalization, remains poorly understood. It is a remarkable fact that the availability of public support for internationalization goes largely un-noticed. According to a European Commission study (European Commission 2010b), only 16 per cent of European SMEs are aware of public support initiatives for internationalization, and only a limited number of SMEs use public support. In the USA, only 23 per cent of exporting manufacturers have used public support designed to promote exports (European Commission 2010b).

Therefore, in this chapter we place particular emphasis on the interaction between public policies, and other measures, to stimulate commercial and financial practice instrumental to promoting internationalization. This is an area that merits systematic research, as so many economies employ such measures, aspiring to harness the SME sector to the generation of economic growth at home. The topic of policy action for internationalization is prominent in the political programmes of Europe and elsewhere. For example, in the EU the backdrop is the Growth Agenda (prominent in the plans of the Juncker Commission) which hinges to a large extent on SMEs and entrepreneurial firms contributing to growth (again, particularly via internationalization). But exactly how the mechanisms of promotion—issues to do with the availability and terms of finance, awareness-raising measures, knowledge acquisition measures, capacity-building measures and so on—work needs to be fully comprehended, and then utilized, to serve the ultimate objective of contributing to economic growth. An effective SME internationalization policy aimed at enhancing international entrepreneurship is needed, taking into account the perspectives of all the key actors involved, broadly speaking policy makers and practitioners, together with academics.

We start by reporting some characteristics of the SMEs sector at the EU level, to underline their crucial role in the economy and their importance for the international dimension. We then discuss (1) perspectives taken within academia to analyze the topic of SME internationalization, (2) policy initiatives at the EU level and (3) perspectives from commercial and financial practice. In the second part of the chapter, we discuss the interaction of the spheres of policy, finance and the Growth Agenda, and how collectively they enhance the internationalization of SMEs. Finally, we present a number of avenues for inquiry that need to be addressed in future research.

SMEs and Internationalization: EU Dimension

SMEs are the backbone of the European economy. In the EU, SMEs account for 99 per cent of all businesses (European Commission 2015a). They represent 67 per cent of total employment and create 8 per cent of gross value added. The EU institutions (by which we mean, principally, the Commission, the Council and the Parliament) conceive of internationalization as being categorized as either (1) within the EU single market or (2) outside the EU, involving third countries. According to data from the European Commission (European Commission 2010b), SME internationalization is important for four reasons. First, international activity by an SME correlates strongly with higher turnover and growth. Second, SMEs that are internationally active tend to report higher rates of employment growth. Third, there is a strong and positive relationship between internationalization and innovation. And last, the drivers of SMEs' growth are increasingly found to be within emerging markets and the fast-growing economies of third countries beyond Europe. In fact, according to the study *Internationalization of European SMEs* (European Commission 2010b), internationalized SMEs report employment growth of 7 per cent versus 1 per cent for those without any international activities. There is also a strong relationship between SME internationalization and innovation. Twenty-six per cent of international SMEs (versus only eight per cent of domestic SMEs) introduced products or services new to their domestic sector. EU SMEs classified as international are mostly active in the EU internal market—only 13 per cent are active in the markets of third countries.

The fact remains that only a small proportion of European SMEs are doing business at the international level either within or beyond the EU. A recent “Eurobarometer” study on SMEs' internationalization (European Commission 2015b) indicates that 33 per cent of EU SMEs have been involved in exporting to another country either inside or outside the internal market in the last three years, with 30 per cent of those SMEs having exported to another EU country. Yet, almost 74 per cent of the SMEs that do not currently export indicate that they would probably never do so. For these firms, the problem they face is the frequent absence of a proper functioning market for providing basic SME internationalization assistance and services. And the leading reason for this is that most SMEs are not able to afford the services that do exist, as these are mainly designed for big companies. This explains why public authorities have developed a variety of different support

schemes at local, regional, national and European levels (e.g., see European Commission 2013).

Academic Perspective

From the academic point of view, the discussion can be grouped into three broad areas. The first area provides the entrepreneurship/innovation perspective, that is, it focuses on how entrepreneurs and SMEs realize international opportunities; that is, the entrepreneurial processes of learning, networking, collaborating and creating and exchanging knowledge within smaller firms. This perspective explores the capabilities and motivations of SMEs that antecede internationalization. The main research questions are thus: (1) How do entrepreneurs and SMEs identify/create international opportunities? (2) What are the main threats, obstacles and challenges for entrepreneurs and SMEs to initiate international expansion? (3) In particular, what are their main requests to governmental and other institutions? (4) What is the role (and potential role) of public policy and laws in stimulating international entrepreneurship?

The second area focuses on the strategy and growth perspective, that is, on how to transform opportunity into a sustainable and well-performing international venture. This comprises entry and establishment mode choice, export channel selection and competitor identification. Appropriate entry mode choice and export channel selection are crucial, as the mode adopted on entry is very costly to change, and, therefore, it is important to make the correct initial selection, especially for resource-constrained enterprises, such as SMEs. This perspective therefore highlights the decisions that are made by firms and the effectiveness of the decision making. For example, do firms have access to the relevant information, and to the professional skills required for international strategy formation? Answers to these questions will deepen our understanding of the likely receptiveness of SMEs to policy interventions. Here, the main research questions are these: (1) What are the main challenges for SMEs to develop a sustainable and high-performing international expansion? (2) What supportive measures—issues to do with the availability and terms of finance, awareness-raising measures, capacity-building measures and so on—do SMEs need, to foster internationalization growth? (3) How do we balance international performance and growth?

The third area focuses on the institutional perspective, that is, on how institutions and policies can assist the internationalization process of SMEs; that is, the relation between the theory of policy intervention and SME interna-

tionalization. This perspective therefore looks at the overarching question of how our academic and scientific knowledge and understanding of SME internationalization interacts with the institutional and policy dimensions. The main research questions are as follows: (1) How do the public and private sectors evaluate SMEs' international business projects? (2) In conditions of high uncertainty—typical for the internationalization of SMEs (being resource limited) in which it is not possible to estimate the return on investments—do finance providers make their financing decisions on different grounds for SMEs as compared with large corporations? (3) What kind of new, if any, tools are governments and the private sector searching for with which to promote SME internationalization, and what tools they ought to be seeking? (4) What future theoretical developments are needed?

Initiatives at the EU Level

The European Commission has instituted a number of initiatives to support SMEs in general. The most important reference document is the Small Business Act, launched in 2008 and reviewed in 2011 (European Commission 2008, 2011, see also http://ec.europa.eu/growth/smes/business-friendly-environment/small-business-act/index_en.htm). This Act contains a set of guiding principles which have been decided by the EU to direct member states towards issues that require careful attention. The Small Business Act is focused on access to finance, fostering entrepreneurship and facilitating access to markets for SMEs (including the international dimension). More practical support for internationalization is offered through some of the actions set out below:

- *Enterprise Europe Network* (<http://een.ec.europa.eu/>). In each European country, there is a network which is funded by the European Commission and which is constituted mainly by chambers of commerce and regional business representative organizations. This network has the task of advising SMEs, facilitating access to international markets and helping with the identification of partners in third countries.
- *EU SME Centre in China* (<http://www.eusmecentre.org.cn/>). This is a very light structure which offers a first line of advice for European SMEs considering entering the Chinese market. They have a web-based diagnostic tool for SMEs to check if they are ready to enter the Chinese market. They also organize training sessions and information sessions on do's and don'ts when entering the Chinese market.

- *SME IPR Helpdesk* (https://www.iprhelppdesk.eu/SME_Corner). This is an agency specialized in advising SMEs on the protection of intellectual property. There are three helpdesks focused on different geographic regions: greater China, South East Asia and Latin America.
- *European Investment Plan* (http://europa.eu/rapid/press-release_IP-14-2703_en.htm). Through the European Investment Bank, the European Commission supports certain national banks to ease access to finance for SMEs.
- *SME-specific credit risk assessment*. The European Commission is developing a specific credit risk assessment method which is tailored to SMEs, to take account of their specific and distinct needs compared with larger companies.

Banking Sector Perspective

There are three salient contextual elements for SMEs' internationalization that banks take into consideration: confidence, competence and connections.

- *Confidence* to cross the border, which is of two types. First, "Border out" is everything that a country does in support of its businesses in the market beyond its borders (e.g., marketing, promotion and sponsorship). Second, "Border in" is everything that a country can do to support the improvement of competitiveness (e.g., knowledge, skills and attitude) within the businesses themselves, in order to be ready to take advantage of the opportunities beyond the border. "Border-in" intervention is by far more effective in generating improvements in SME internationalization performance. The challenge is to find out how to improve the competitiveness of businesses rather than simply generating more opportunities for them.
- *Competence* is composed of two dimensions. First, the level of business competency refers to SME capabilities and can be categorized as follows: inexperienced, experienced or expert in internationalization. Second, the nature of business support can be categorized as being information, advice and assistance. For each SME it is important to identify what kind of support is needed. Inexperienced SMEs search for information; experienced SMEs look for advice and expert SMEs need assistance.
- *Connections*. Large multinationals are very well globally connected. SMEs, on the other hand, are poorly connected, and a global map of SME connections would be much more fragmented and fractured.

The banking sector views innovation as a necessity for successful businesses, particularly those engaged in internationalization—the logical reason being that the firm must be bringing something new to the market. According to this view, innovation is a function of ideas and ideas are a function of connections. So, the conclusion is that policy should promote the formation of connections that are found in networks, in order to help SMEs generate ideas. The principle is that these networks deliver content, facilitate collaboration between members of the networks and facilitate connections with other networks.

In summary, in order to promote the internationalization of SMEs, policy makers, financial institutions and companies themselves should (1) focus on Border-in, rather than Border-out approaches, (2) use a competency matrix as the basis for establishing the nature of support required and (3) deliver content, collaboration and connections via networks.

Evergreen Problems with SMEs' Internationalization: Some Ways Forward from Practitioners and Policy Makers

Practitioners in the banking and financial sector and EU policy makers have highlighted some of the same issues as academics, such as the costs of internationalization, risk and access to information and resources. However, they have gone further to identify concrete questions that require concrete actions. Here, we review these questions, the policy response and the remaining policy gaps.

The leading questions from practitioners in business and policy circles are thus: How can SMEs get hands-on experiential knowledge of internationalization, at low risk and low cost? What initiatives from the banking and financial services sector, and what new policy perspectives address, or will address, the problem of inadequate experience? In answer to the demand for action, the following are representatives of current practitioners' and policy makers' guidance:

- Erasmus for young entrepreneurs (<http://www.erasmus-entrepreneurs.eu/>). This is a programme that the European Commission started in 2009, which allows a young (i.e., non-experienced) entrepreneur to spend from one to six months in a different country with an experienced and successful entrepreneur. Usually the entrepreneurs going abroad are under 40 years of

age, and the host entrepreneur is below 50. The programme is focused on learning by doing at relatively low cost. After five years of this programme, evaluation shows that 90 per cent of the programme's new entrepreneurs acquired knowledge about new markets during the exchange; 80 per cent of new entrepreneurs established a broad range of international contacts. And nearly two-thirds of host entrepreneurs reported that they also benefited from the experience by acquiring knowledge of foreign markets through hosting the young entrepreneurs.

- Employ international resources that are relatively easy to access and are nearby. For example, international students (via internships or placements). Such a strategy confers knowledge of the home markets of the students on the SME and helps to facilitate connections with these markets to the benefit of the SME.
- Recruit people who are already internationally experienced.
- Participate in trade missions, including inward trade missions, and exhibition visits.

A universal question is this: How are the support programmes for SMEs' internationalization promoted, that is, how do you reach the SMEs? The issue of raising awareness of programmes' existence and of effective communication is crucial to firms being in a position to benefit. The mechanisms include:

- Bank promotion through a number of directors in local branches that have a portfolio of companies. It is the responsibility and duty of these local branches to push information and opportunities to their customers. In addition, banks also maintain active contact with trade associations, accountants, lawyers and universities to employ their networks for communication with SMEs.
- The European Commission usually does not itself communicate directly to SMEs because the target audience is both very broad and diverse. Rather, the Commission passes information through business intermediary organizations. Recently, the Commission started to organize regular meetings with national trade promotion organizations to share best practices and to develop common approaches across the EU for the support of SMEs' internationalization.

Given the need for the expenditure of resources, in particular innovation, the question arises: Does internationalization have any effect on the (potential) bankruptcy risk of SMEs, and does the innovation intensity of interna-

tionalizing SMEs have any effect on the (potential) bankruptcy risk of the SMEs? To date, the answer seems to be that:

- Internationalization does affect the potential bankruptcy risk of SMEs. All SMEs operate relatively close to breakeven, because this is the nature of business for SMEs. However, while there is no correlation between internationalization and profitability, profitability should exert a mitigating effect on the potential for bankruptcy risk.
- Innovation, being necessary for internationalization, should mitigate the risk associated with internationalization. Innovation intensity should then reduce the potential for bankruptcy risk, as it increases the probability of success.

A crucial question that lies outside the strictly economic domain, and to which the answer is at least in part, likely to be socially determined is this: How is failure considered and what are the possibilities regarding alternative sources of financing? This question may be at the root of international differences in entrepreneurial risk taking. Within the EU and, as is exemplified well in the UK, traditional lenders (i.e., banks) are the dominant source of finance:

- The risk algorithms that traditional lenders employ dictate the decision to finance. This means that people who have previously experienced business failure inevitably score a range of “red lights”. Even so, in cases of high risk scores, some banks will offer two alternatives. First, to pull in other potential sources of finance—for example, venture capitalists, crowd funders, other banks—to reduce the risk for the individual bank concerned. Second, to provide non-financial ways to support the firm, such as through financial consultancy, assisting access to new customers, recruiting productive people into the business and reducing costs.
- The European Commission, being aware of the problem of finance for firms that appear to be risky for reasons of legacy, is promoting greater action at the national level to give second chances to entrepreneurs.

Discussion

The EU, its member states, the USA and the advanced economies in general look at their SME sectors to emulate the industrial growth performance of the world’s high-growth—today, typically the emerging—economies. In the context of the developed economies, it is necessary to adopt an effective

SME policy towards internationalization, not least because internationalization alone offers the growth opportunities that SMEs require. The evidence demonstrates that policy should be aimed at enhancing international entrepreneurship and be designed with due account taken of the perspectives of all the relevant actors, that is to say, policy makers and practitioners, and also academics who, through research, education and training, have the potential to aid the design and optimization of policy. The concrete actions that transpire as promising are (1) strengthening the partnership between the private and public sectors, (2) the provision of educational programmes for SMEs, (3) the expansion of loans and loan guarantee programmes and (4) the provision of better intelligence support. To enable this, future research is needed to focus on the following areas:

- *Strengthening the partnership between the private and public sectors.* There are certain things that government does especially well, and others that the private sector does especially well. In the USA, for example, the federal government is strong at market research, financing and coordinating certain types of efforts beyond the means of SMEs. This type of private–public partnership needs strengthening and further development in Europe.
- *The provision of educational programmes for SMEs.* At present, numerous governments offer educational programmes in general business and international trading opportunities. However, training on internationalization and related topics specifically tailored for SMEs remains limited. Such training can be underpinned through workshops, seminars and other educational programmes that might, for example, be offered to SMEs by government agencies, based on sound research to establish what works best. The state of scientific knowledge on the requirements of SMEs, and on the mechanisms through which policy actually works upon them, is inadequate, and at present it remains unclear what the projected effectiveness of policy interventions will be. Sufficient evidence on the objective value of such programmes has not yet been established.
- *The expansion of loans and loan guarantee programmes.* Perhaps the greatest problem that small companies are reported to face in internationalization is accessing sufficient capital. The problem can be addressed via low-interest loans and loan guarantees. Numerous government agencies provide such loans, but these schemes often do not reach SMEs—their intended target. Evidence from Europe and from North America both suggests this. Of itself, this offers scope for theorizing as to why this might be the case. Such support programmes are especially important for SMEs because many such firms may be unable to obtain, or to afford, loans from conventional, pri-

vate sources. Research into policy intervention generally suggests that programmes need to be promoted more effectively and expanded. The problem of awareness is persistent and ubiquitous—a failing which demands concerted research.

- *The provision of better intelligence support.* It is the role of public and private suppliers of market research and intelligence to cater to SMEs, to assist them in preparing for and dealing with internationalization efforts. But what is the optimal level of this public support, and how far is it contingent upon support for building capabilities first, that is, Border-in interventions?
- *The encouragement of free trade and economic development worldwide.* Just as barriers to transacting domestic business bear disproportionately upon nascent and smaller enterprises, in the international domain, the effective and efficient governance of international trade and investment is particularly important to SMEs. The ideal position is that the World Trade Organization and numerous major governments should continue to encourage and stimulate free trade and economic development around the world. Free trade is theoretically, and is demonstrated to be, the most effective means for alleviating poverty in developing economies—though contingent upon other supportive policies, for example, as directed towards the Sustainable Development Goals (United Nations 2016). National economic health and national stability depend to a large extent on economic development that is stimulated by international trade. In the post-Doha world, with a lack of closure in multilateral barriers reduction, the leading economies, and economic groupings, are increasingly pursuing non-multilateral trade and investment policies. It is an open question, but amenable and suitable for research to consider, how the deviation from multilateralism might impact upon the representation of SMEs' best interests within this new generation of agreements—for instance, within the projected Transatlantic Trade and Investment Partnership and, in turn, upon the internationalization of SMEs.

From the above agenda, we can draw immediate questions for future research that will be extremely useful to enhance the internationalization of SMEs. First, a large number of programmes offered both by the public institutions and by the private sector are passive. In other words, it is up to the individual SME to be interested in internationalization and go looking for support. This underscores the perennial issue of poor awareness of the support available—but also that only a third of European SMEs are interested in

internationalizing. It remains a question for research as to how the remaining two-thirds can be shifted towards the international involvement that will be necessary to serve the Growth Agenda. What more, that is proactive, can be done? Second, is it necessary to be first innovative and then become international? It is a common understanding that it is the innovative firms that transition to going international, but what evidence is there that going international will help SMEs to become more innovative, as *prima facie*, appears to be the case for the rising tide of entrepreneurial firms from the emerging economies. What then is the relationship between internationalization and innovativeness? Third, what is the relationship between the ability of a certain region to trade strongly with foreign countries and its attractiveness in terms of inward investment? In other words, is there a spillover effect between the promotion of internationalization by local SMEs and the ability to attract foreign investments? And, finally, what are the fundamental causes of the marked and persistent differences between economies in the rate of new enterprise start-up, the turnover of enterprise and the long-run size and international growth of the SME sector and, in particular of the inferior growth within Europe as compared with the USA?

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