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EDITED BY HELGA MEYER, REBECCA PORTERFIELD, REINHOLD ROTH

| Volume

4

# MANAGING SMES INTERNATIONAL BUSINESS STRATE- GIES – THE CASE OF EAST TENNESSEE

REINHOLD ROTH | JON L. SMITH (EDS.)



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Edited by  
Reinhold Roth • Jon L. Smith

With contribution by  
Jon L. Smith • Victor Kimmel •  
Alain Bridwell • Audrey Depelteau •  
Andrew J. Czuchry • David Roach •  
Emily van Dop • Michael Lehrfeld

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At the beginning of the 21st century, the ETSU College of Business and Technology and the HSB School of International Business have carried out a variety of research projects in the field of SMEs and entrepreneurship, among them, from 2001 – 2003, the project “International Quality Networks IQN”, where ETSU contributed an essential part of developing an International MBA of the HSB in the framework of the International Business School Alliance (IBSA), including the whole content for the specialization “International Entrepreneurship”. As part of these collaborative efforts, two international conferences organized by ETSU and HSB were held to share their results; the International Conference on Entrepreneurship and Business Incubation, 2003 in Bremen, and the Conference on Global Entrepreneurship and Business Incubation, 2005 in Atlanta. In 2015, ETSU and HSB renewed their close relationship by developing a new research project “Internationalization of SMEs”.

The partnership between the universities continues to produce significant contributions. Reciprocal teaching assignments, student exchanges, joint research efforts, university – industry partnership and consulting opportunities have become an important part of the intellectual landscape of ETSU and HSB. A cadre of dedicated faculty members are working together to create a unique sustainable academic environment, whereby the colleagues of our several universities see themselves as members of a single, global faculty. By building upon one another’s strengths and cultural insights, the member universities are developing a common faculty model of “Integrated Diversity”. Among these many faculty members who have contributed to this effort, we are extremely indebted to those who were there at the beginning of this effort including, in alphabetical order:

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*Reinhold Roth*

*Jon L. Smith*

*Bremen / Johnson City 2017*

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## Introduction

A few years ago, a medium sized German manufacturing firm began to explore the possibility of expanding its operations to the United States' market. The firm's management team had concluded that the expansion of their operations held the potential for not only increasing sales volumes but to also mitigate the risks associated with domestic market fluctuations. However, while the firm had been quite successful in developing their domestic market in terms of supply chain and distribution networks, there was a lack of internal managerial expertise with respect to the activities required to establish an international presence. The expense and time required to locate and evaluate potential sites suitable for the establishment of a subsidiary and to develop the necessary personnel resources and marketing and distribution networks seemed to be an insurmountable barrier to internationalization.

Coincidentally, a U.S. regional economic development agency tasked with industrial recruitment was exploring the possibility of reaching out to small and medium sized manufacturing firms in the European Union. The agency, the Northeast Tennessee Valley Regional Industrial Development Association or NETVRIDA, is funded by eleven power distributors with service areas in Northeast Tennessee and Southwest Virginia and has close ties with the Tennessee Valley Authority (TVA). NETVRIDA had been promoting and marketing business locations in the 13-county region of the Northeastern Tennessee and Southwest Virginia for over twenty years and had developed a reputation for successfully matching manufacturing firms with superior industrial sites.

After considerable research, the NETVRIDA's executive director determined that small and medium sized companies that make up Germany's *Mittelstand* represented a market segment that would be receptive to the competitive advantages offered by expansion into the U.S. and locating in the strategically situated Northeast Tennessee/Southwest Virginia region. Much like the German manufacturing firm, the NETVRIDA was faced with limited in-house expertise and financial constraints. There were however a number of existing resources within the region. There was another German manufacturing firm that had been successful in locating in Eastern Tennessee some years before and whose management was eager to assist in these efforts. The TVA had a longstanding relationship with a German consultant residing in Germany and the local university had a long standing academic exchange relationship with the Hochschule Bremen City University of Applied Sciences and routinely recruited graduate assistants from Germany for their MBA program.

Eventually, representatives from the manufacturing firm met with the executive director of the NETVRIDA and began working together. After several months, the firm hired a graduate of the university's German language program

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to serve as a local representative and established a presence in the business incubator owned by the university. Within three years, the firm had purchased a building and had begun to develop plans for locating a manufacturing facility in Northeast Tennessee.

This successful example of the internationalization of a Mittelstand or Small to Medium Sized Enterprise (SME as they are known in the United States) is an example of a growing awareness of the opportunities for even the smallest of firms to engage in international commerce through exporting, importing or foreign direct investment. The revolution in telecommunications has drastically reduced the cost of transporting material goods, sharing information and providing a variety of services across geographic space. There is also an awareness that domestic policies supporting the SME's expansion into international markets can contribute to the stability of domestic economies and promote product innovation. Yet, many SME owners and some local decision makers are unaware of the opportunities for their engagement in the international marketplace.

The objective of this volume is to aid SMEs in their efforts to internationalize. Providing theoretical management expertise and practical insights – from experiences made in East Tennessee – may help SMEs to understand some of the opportunities and obstacles that those wishing to enter the global market place will face.

The following chapters are structured in three parts:

In part I, Jon L. Smith is analyzing the place that SMEs occupy in domestic economies and the basic dynamics of SME economics. Victor Kimmel is describing the main business models, methods and tools that SMEs have or will encounter in their efforts to internationalize.

Part two is focused on issues that SMEs may typically deal with: managerial challenges, financial risks, legal regulations and the possibility of using incubation facilities to gradually enter international markets. Victor Kimmel is presenting a case study detailing the experience and lessons learned by a German firm that has successfully internationalized by establishing a subsidiary in East Tennessee, USA. Alan Bridwell gives practical advice from his many years of experience as a leader in regional economic development, including incentives and services offered by the Northeast Tennessee Valley Regional Industrial Development Association (NETVRIDA). Audrey Depelteau is explaining resources, functions and services of the Innovation Lab, an ETSU affiliated operated business incubator. She is also demonstrating the benefits of the Soft Landings programs for two SMEs that have been in transition in entering the U.S. market.

Last, part III is departing from familiar islands to current and future challenges for SMEs. Andrew J. Czuchry is investigating the advantage of coaching points and guidelines for successful leadership in small to medium sized engi-

neering firms, how to market technical innovations and implement evolutionary change into the DNA of an business organization. David Roach and Emily van Dop are introducing a type of SME that has been evolving in a business setting driven by digitization, connectivity, new knowledge creation and globalization. They explain a new paradigm: the Born Global SME. Based on a case of a Canadian corporation in the medical device industry, they set out distinctive patterns, managerial skills and strategies of a born Global SME. Michael Lehrfeld will outline simple but actionable steps that any company can use to increase their corporate security posture as they expand into the global marketplace.

Overall, the issues and perspectives in this book are an effort by academics and practitioners to assemble a body of practical information that will acquaint entrepreneurs and SME managers with economic justifications for pursuing a strategy for internationalizing their operations and will provide practical insights gleaned from the experiences of other firms that have extended their operations across international boundaries. Although it is not intended to be a “how to” manual, it will provide useful information for SMEs wishing to begin a strategic planning process that is a necessary precursor for successful internationalization.

*Reinhold Roth*  
*Jon L. Smith*  
*Bremen/Johnson City, 2017*



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**Part I:**  
**Small is not only beautiful, it really matters**

**Jon L. Smith**

**SMES – An Economic Overview**

# 1 Introduction

When discussing macroeconomic policies, there has been a tendency for policy makers to concentrate upon businesses what are considered “major players” in the national or international context. Likewise, the focus of much economic research has been upon the role of “major industries” when examining questions of productivity, job growth and contributions to the growth of GDP. Small to medium sized enterprises (SMEs) are typically mentioned only in passing, if at all. Indeed, the small business sector has been described as “... what a cynic might define as those businesses that economists hardly ever study” (Bruce, 1989). This lack of interest in SME economics may be attributed to the assumption among some economists that, given the existence of scale economies, only large firms had the capacity to be “efficient” (Galbraith, 1956, 1967). The tendency to concentrate upon large enterprises has also often justified in terms of practicality. The extremely heterogeneous composition of the small business sector simply made it too difficult to draw empirical generalizations, the grist for academic journal articles. (Julian, 1993)

Today however, there is an increasing awareness of the importance of the place that SMEs occupy in the overall business landscape and a growing awareness of their importance not only to regional economies, but to national economies as well. SMEs are increasingly the focus of academic research and have come to be viewed as one of the cornerstones of entrepreneurial development and job creation.

The work of Joseph Schumpeter is frequently cited as a theoretical touchstone for the importance of SMEs. Schumpeter felt that a foundation of capitalism was innovation, “The sweeping out of old products, old enterprises, and old organizational forms by new ones.” (Schumpeter, 1942) He referred to this process as “creative destruction” where firms that constantly innovate and develop new products and processes replace those older firms that don’t. Schumpeter felt that although innovation tended to be an activity undertaken by very large firms, there was an inherent tendency for large enterprises to become increasingly bureaucratized, a development which eventually stifles innovation and lead to declines in their competitive advantages.

Support for this position can be drawn from indications that the correlation between the number of new patent filings and the rate of product and production innovation tends to be quite low among larger firms and much

higher among smaller firms (Acs and Audretsch, 1988). While both small and large firms give rise to significant innovations, it has been suggested that the absence of an entrenched bureaucracy and the fact that SMEs face more competitive markets provide stronger incentives for owners innovate. (Edmiston, 2007)

This view is supported by a number of studies found that although *industries* in which large firms appeared to be more dominant had higher levels of innovative activities, those innovative activities were actually most likely to occur in smaller *firms* in those industries. That is, smaller *firms* were the innovators in the “more innovative” *industries* suggesting that these smaller firms are the true instruments of creative destruction. (Acs, 1997) Given that in terms of overall numbers of firms, SMEs make up the majority of businesses enterprises in all national economies, this is important conclusion.

Not only are the numbers of SMEs significantly greater than the numbers of large firms, the number of their employees represents a significant proportion of the total labor force. Over one-half of all employees in the United States and almost two-third of those in the EU are employed by small to medium sized firms. There is a considerable body of research showing that these smaller firms are not only important sources of innovation, they also tend to provide some stability during economic downturns in that they are slower to shed jobs than larger firms. Within the European Union and the United States there has been a rising awareness of the importance of SMEs to both the European and U.S. economies as is evidenced by the EU’s adoption of the Small Business Act in 2008 and resources devoted to the U.S. Small Business Administration in the U.S.

## 2 The Place of SMEs in National Economies

Early in the twentieth century, a number of researchers began to discuss the place that SMEs occupy in the structure of national economies. In 1931, Robert Gibrat noted that firm sizes within an economy tend to follow a lognormal, positively skewed distribution characterized by large numbers of firms of small firms and relatively few very large firms. (Gibrat, 1931) This type of distribution is often referred to as a Zipf distribution after George Kingsley Zipf who modeled the frequency of word usage. This distributional pattern, often termed “Zipf’s Law”, has been documented in numerous studies of business size distributions over the years. For example, working from census data, Axtell (2001) found that the firm size distribution for the entire population of US firms is consistent with Zipf’s law while Fujiwara et al (2004) reported similar results in a number of European countries. An examination of data on national economic structures of the European Union and the United States provides confirmation.

Smaller firms are often referred to as SMEs, however there is no universally accepted definition of what actually constitutes an SME. SMEs are typically defined in terms of a firm’s number of employees and/or annual revenues or turnover. These threshold measures for SME definition vary by geography. To add to the uncertainty in discussions of SMEs, the particular term used to refer to a small business may also vary from discussion to discussion. One often encounters the terms enterprise, establishment and firm used interchangeably. Although similar, these terms are not synonymous. An enterprise is typically defined as “a business or membership organization consisting of one or more establishments under common, direct or indirect, ownership or control” while a firm is “a business organization consisting of one or more domestic establishments in the same state and industry that were specified under common ownership or control. The U.S. Small Business Administration (SBA) defines an establishment as “A single physical location where business is conducted or where services or industrial operations are performed”. The terms firm and establishment are therefore synonymous the same for single-establishment firms.

The SBA defines a business entity with several establishments in the same industry within the same US state as one firm. Although each establishment might be small enough to be considered a “small business”, the multi-establishment firm’s employment and annual payroll are summed over all the associated establishments. (US Census Bureau, 2015) If these



sums are below the definitional threshold, the multi-establishment firm can be classified as an SME. The EU defines an SME using an enterprise basis. An enterprise may be either “autonomous”, “a partner enterprise” or a “linked enterprise”. This differentiation is important when examining data with regard to implications to the existence of economies of scale within a firm. The tables below show comparisons of SME definitions and industrial structures in the EU and the U.S.

In the European Union, SMEs are defined in terms of the number of employees (staff headcount), annual revenues, and/or annual balance sheet asset totals.

	<b>Micro Enterprise</b>	<b>Small Enterprise</b>	<b>Medium-sized Enterprise</b>
<b>Number of Employees</b>	<b>&lt; 10</b>	<b>10 to 49</b>	<b>50 to 250</b>
<b>Turnover OR</b>	<b>≤ €2,000,000</b>	<b>From €2,000,001 to ≤ €10,000,000</b>	<b>From €10,000,001 to under €50,000,000</b>
<b>Balance Sheet</b>	<b>≤ €2,000,000</b>	<b>≤ €2,000,000</b>	<b>Greater than €2,000,000 to under €43,000,000</b>

*Source the new SME definition: User guide and model declaration. The European Commission p. 14*

In the EU, an SME is an enterprise that employs 250 or fewer employees with annual turnover of under €50,000,000 and balance sheet maximums of under €43,000,000. SMEs in the EU are further classified as being a “micro”, “small”, or “medium-sized”. Table 1 shows their definitions according to the numbers of employees, annual turnover and balance sheet values. Enterprises in the EU may meet either the staff headcount thresholds or the balance sheet ceiling to qualify as an SME. Exceeding one does not change its legal status.

In the United States, the definition of an SME varies across governmental entities. In an effort to account for perceived differences between firms in the manufacturing, agricultural, and service sectors, the U.S. Department of Commerce (Commerce), the U.S. Small Business Administration (SBA), and the U.S. Department of Agriculture (USDA) have established different technical thresholds in terms of the type of economic activ-

ity, the number of employees (full and part-time workers across all of an enterprise's associated establishments) and/or their annual revenues consolidated across all associated establishments. The table below shows the current technical thresholds used in the United States

		Exporting Services Firms		
	Manufacturing and non-exporting service firms	Most	High Value	Farms
<b>Number of Employees</b>	< 500	< 500	< 500	< 500
<b>Revenue</b>	Not Applicable	≤ \$7,000,000	≤ \$25,000,000	< \$250,000
<b>Defining Institution</b>	SBA Advocacy	SBA/SBA Advocacy	SBA/SBA Advocacy	USDA
<b>Data Source</b>	U.S. Census	ORBIS	ORBIS	USDA

Industry Canada defines SMEs in a fashion similar to the U.S. definition. Businesses with fewer than 500 employees are generally defined as SMEs. As in the EU, Canada subdivides SMEs into different categories. A micro business is defined as a business with fewer than five employees. Goods-producing small businesses are defined as businesses having fewer than 100 employees while service-based businesses with fewer than 50 employees are classified as “small”. However, Statistics Canada defines an SME as any business establishment with 0 to 499 employees and less than \$50 million in gross revenues.

Number of Enterprises – EU -2012						
	Micro	Small	Medium	SMEs	Large	Total
<b>Number</b>	18,783,480	1,349,730	222,628	20,355,839	43,454	20,399,291
<b>%</b>	92.10%	6.60%	1.10%	99.80%	0.20%	100%
Number of Firms – US -2011						
	Micro*	Small	Medium	SMEs	Large	Total
<b>Number</b>	26,527,161	977,232	176,506	27,680,899.0	36,510	27,717,409
<b>%</b>	95.71%	3.53%	0.64%	99.87%	0.13%	100.00%

Regardless of the definitional syntax, as the Table 3 demonstrates, the structures of the U.S. and EU economies are almost identical in terms of firm size distributions. For each economy, SMEs account for over 99% of the total number of establishments/firms. The contribution of SMEs to total domestic is also almost identical for both economies. As Table 4 indicates, SMEs accounted for almost two-thirds of EU employment in 2012 and over half of US employment in 2011.

<b>Table 4 Employment Structure EU in 2012 vs. US in 2011</b>						
<b>EU Employment – 2012</b>						
	<b>Micro</b>	<b>Small</b>	<b>Medium</b>	<b>SMEs</b>	<b>Large</b>	<b>Total</b>
<b>EU Employment*</b>						
<b>Number</b>	<b>37,494,458</b>	<b>26,704,352</b>	<b>22,615,906</b>	<b>86,814,717</b>	<b>43,787,013</b>	<b>130,601,730</b>
<b>%</b>	<b>28.70%</b>	<b>20.50%</b>	<b>17.30%</b>	<b>66.50%</b>	<b>33.50%</b>	<b>100%</b>
<b>US Employment – 2011**</b>						
<b>Number</b>	<b>35,688,588.0</b>	<b>19,111,263.0</b>	<b>17,493,851.0</b>	<b>72,293,702.0</b>	<b>62,808,500.0</b>	<b>135,102,202.0</b>
<b>%</b>	<b>26.42%</b>	<b>14.15%</b>	<b>12.95%</b>	<b>53.51%</b>	<b>46.49%</b>	<b>100.00%</b>

*Sources: \*ANNUAL REPORT ON EUROPEAN SMEs 2012/2013. P. 10;*

*\*\* U.S. Small Business Administration, Office of Advocacy*

This pattern holds for other economies as well. Suominen suggested that in many Latin American and Caribbean economies over 90% of firms are SMEs (Suominen, 2013) while Zhang and Xia indicate that in China 98% of firms are SMEs and that they provide seventy-five percent of China's urban employment opportunities. (Zhang, 2007)

Even more important than their sheer numbers is the contribution of SMEs to a nation's economy's vibrancy. Van Praag and Versloot noted that entrepreneurial firm tends to be "...small, young and productive with innovative capabilities that positively contribute to overall job creation (Van Praag and Versloot, 2008). SMEs not only make up more than 95% of market participants and contribute around 50% of direct value added or production (OECD, 2004), but there is also evidence that they tend to make a disproportionate contribution to new job growth. In his analysis of job creation in the U.S., David Birch argued that SMEs were the primary source of job growth and the most important source of job creation in the U.S. economy. Birch claimed that that 66% of all net new jobs in the United States during 1969-1976 were created by firms with 20 or fewer employees and 81.5% were created by firms with 100 or fewer employees

(Birch, 1981) In his later work, he maintained that during the period 1981-1985 firms with fewer than 20 employees accounted for 82% of employment growth via expansion and contraction of existing firms (Birch, 1987).

Although Birch's methodology and numbers were questioned, later work supported his contention that SMEs are indeed important sources of job creation. When examining net job creation, where net new jobs are defined as the total of new jobs created by firm startups and expansions, gross job creation, minus the total number of jobs destroyed by firm closures and contractions, gross job destruction, Edmiston found that for the period 1990 to 2003, small firms (less than 20 employees) in the United States accounted for 79.5% of the net new jobs while midsize firms (20 to 499 employees) accounted for 13.2% of the net new jobs and large firms (500 or more employees) accounted for only 7.3%. The job creation numbers must be viewed with some caution for as Edmiston pointed out, gross job flows are considerably larger than net job flows. When corrected, the small firm job creation numbers from 1990 to 2003 showed that small firms created almost 80% of net new jobs but less than 30% of gross new jobs. When examining gross as opposed to net job losses, small firms accounted for about 24% of job losses while large firms suffered 43.5% of gross job losses. (Edmiston, 2007).

More recent work using corrections for firm age have confirmed an inverse relationship between firm size and job growth. Neumark found that small firms do create more jobs on net, although the difference is much smaller than Birch's methods suggest and that a negative relationship between establishment size and net job creation holds for both the manufacturing and services sectors. (Neumark, 2011) Similar results were reported by Halitwanger. (Halitwanger, 2013).