

INTERNATIONALIZATION STRATEGIES OF MEDIUM-SIZED GERMAN COMPANIES: AN EMPIRICAL SURVEY

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ABSTRACT

This empirical survey is based on a questionnaire which was distributed to 6,000 medium-sized German companies with international activities. The analyses included responses from a total of 533 enterprises. The areas examined include the importance of globalization, the motives for and the obstacles to globalization, the strategic planning of internationalization, the forms of internationalization adopted, the internationalization of a range of business functions and, finally, the geographical regions targeted by medium-sized German companies in their drive for internationalization. The study offers an up-to-date view of the current situation of medium-sized German companies operating within an international context, and insight into their attitudes towards internationalization.

Key Words: Globalization, Internationalization Strategies, Motives and Impediments of Internationalization, Medium-Sized Companies, Germany, European Union

OBJECTIVE AND DESIGN OF THE SURVEY

Germany is the world's largest exporter after the USA.¹ Some ten percent of total world exports in 1998 came from German companies (Caspers 1999, 31). Medium-sized companies are feeling the effects of internationalization, according to the forecasts of the OECD, the internationalization of medium-sized German companies will continue to expand in future (OECD 1997). With this as background, the question arises as to whether medium-sized companies in Germany are capable of

1. If the aggregated exports of the world's major exporting countries are compared, Germany occupies second place, behind the USA and before Japan, France and England. In terms of annual exports per head of population, Germany, with US \$ 4,813, occupies first place in the ranking (Gilbert 1998a, Gilbert 1998b).

coping with the challenges which result from increasing internationalization. Certainly in a scenario of this type medium-sized companies seem to be in a poorer starting position than large corporations. As a rule, they have less human resources and capital at their disposal. Moreover, they often lack foreign experience and information about international markets, both of which disadvantages can, in turn, lead to management errors.

However, the thesis that the medium-sized enterprise is at a disadvantage as a result of its lack of resources does not take into account the fact that competitiveness is not primarily determined by the size of the business involved. It is, in fact, a function of price, product and other success factors which are not related to price (e.g., customer proximity, flexibility, specialization, and services). The question of whether medium-sized businesses can cope with the increasing internationalization of the economy needs to be examined from a more differentiated point of view. However, with this background of economic importance and the firms' multitude of limitations in resources, it is surprising that very little research exists on the problems involved in internationalization among German medium-sized companies. This descriptive study of internationalization strategies attempts to deal with a number of problems from a variety of perspectives.

The first stage of the questionnaire aims to ascertain the degree of importance the medium-sized business places on increasing globalization, and to determine whether the enterprise is prepared for the problems involved. Here, the motives behind internationalization are of particular interest. An analysis of the motives for internationalization helps us to draw conclusions about the internationalization strategies employed and offers a range of starting points for a profitable discussion of location factors at the international level. Here, we consider whether the widely-accepted thesis that revenue-oriented motives are dominant is also confirmed by the results of our study (compare the empirical studies of Koller, Raithel, and Wagner 1998, Heise 1997). In a further step, we investigate the question of what the greatest obstacles to internationalization are and what steps are being taken by medium-sized companies to overcome these obstacles.

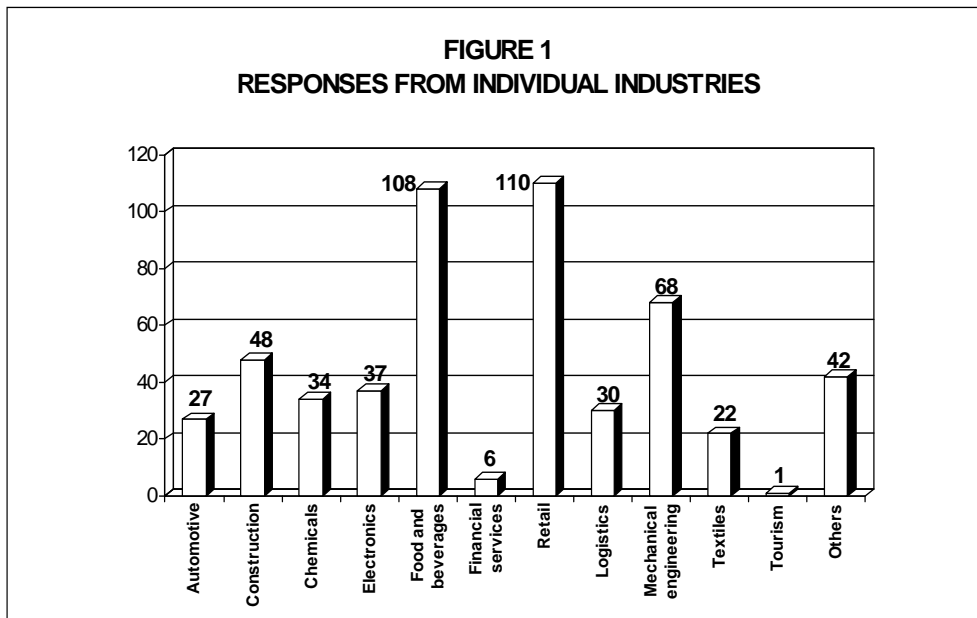
The question of whether or not internationalization processes are planned with specific objectives is a further important issue. In conclusion, we determine which forms of internationalization the medium-sized enterprise has adopted in order to be able to react to the multiple challenges of this process. Whether export is, in fact, the most important form of internationalization and to what extent joint ventures, the establishment of subsidiaries and licensing play a major role is also examined. And finally, in the survey, we examine which geographical regions are of special interest to

medium-sized German companies.²

The study was based on random sampling techniques and has the following structure:

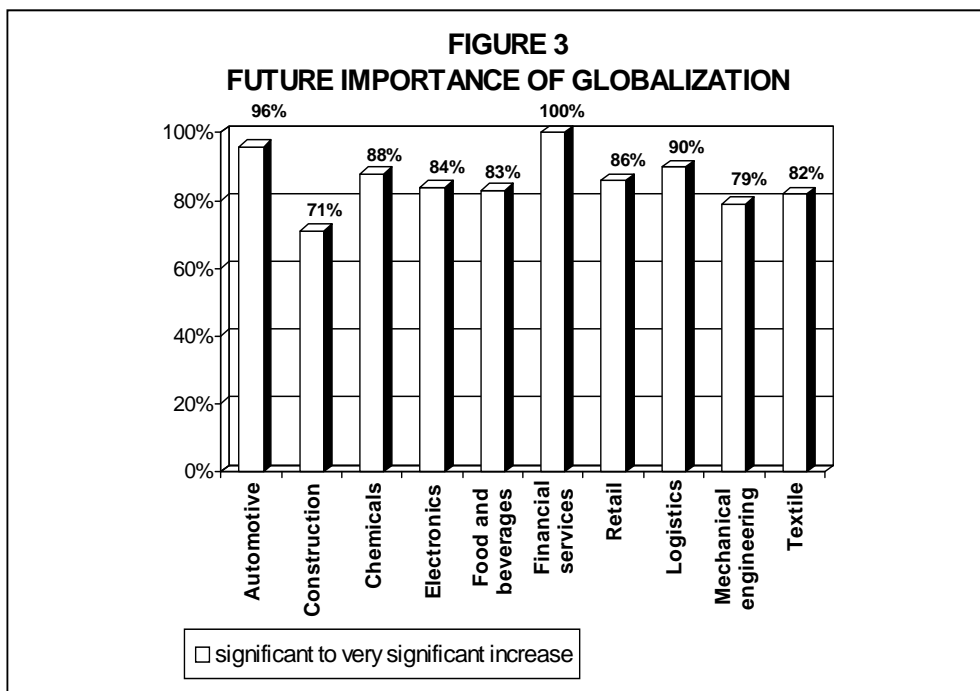
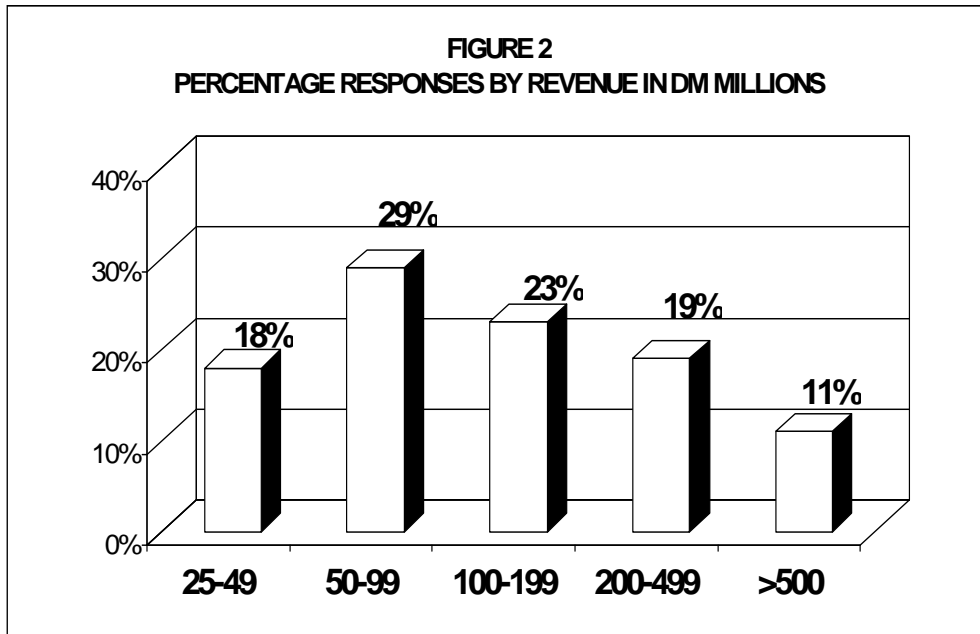
- A total of 6,000 questionnaires were distributed to medium-sized companies.³
- The companies involved have sales revenues of between DM 25 million and DM 1 billion.
- The weighting of the different industries in the random sample is proportional to their share in the 1996 turnover taxes, clustered according to revenue volume classes.
- The period of the survey was between August and October 1998.

In comparison to other empirical studies, the response rate was relatively high (compare the results of Zentes and Swoboda 1999, Koller, Raithel and Wagner 1998, Winkelmann 1997). A total of 533 companies replied, which corresponds to a response rate of 8.9 % (Figure 1 and Figure 2). Even though it is not possible to claim universal validity for a study based on this level of response, the results identify central problem areas experienced by medium-sized companies in the course of internationalization.



² References are made mainly to German publications because of the nature of our survey which deals solely with medium-sized German companies.

³ No uniform classification of medium-sized companies exists in the literature. There are both qualitative (e.g. the company occupies a central position of power) and quantitative (e.g. number of employees and revenue) classification criteria. In our survey, revenue serves as the classification measure for the medium-sized enterprise. The questionnaires were sent exclusively to companies with a total turnover of between DM 25 million and DM 1 billion. For further discussion of the problem of classification of medium-sized companies, see Hamer 1990.



RESULTS OF THE SURVEY

Importance of globalization

The first set of questions was designed to determine what effect the current globalization process has had on the attitudes towards internationalization of the companies polled and how the medium-sized enterprise has prepared itself to face the task. It is evident that all medium-sized companies definitely anticipate that the impact of globalization will be dramatic. Across all the industries, the trend towards increasing globalization is seen as exercising a strong to very strong influence on the activities of the enterprise. Not one single enterprise involved in the sample felt that the influence of globalization would decrease in future (Figure 3).

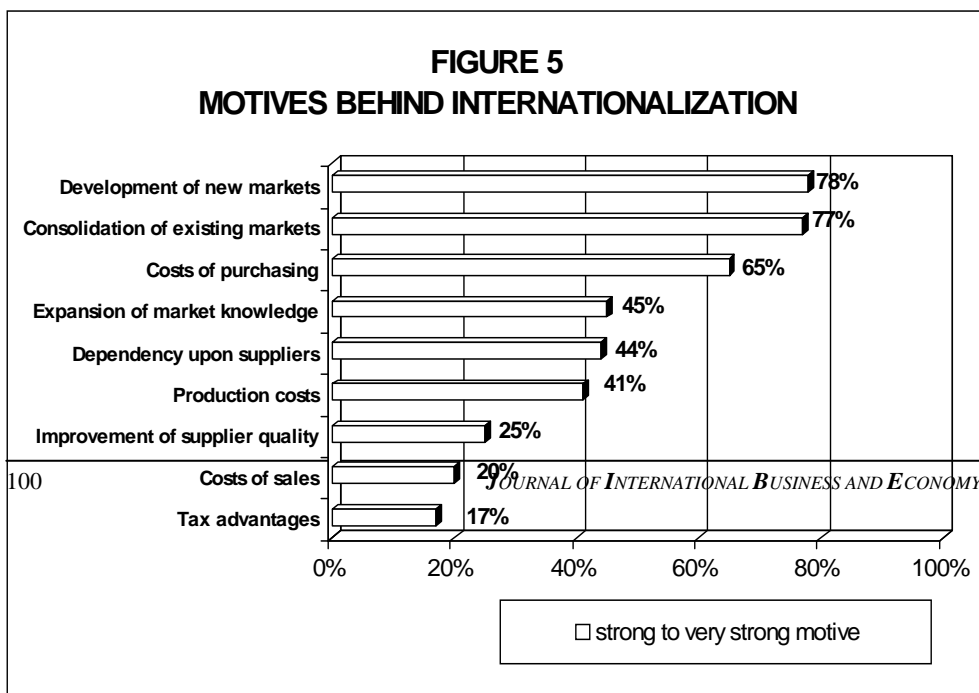
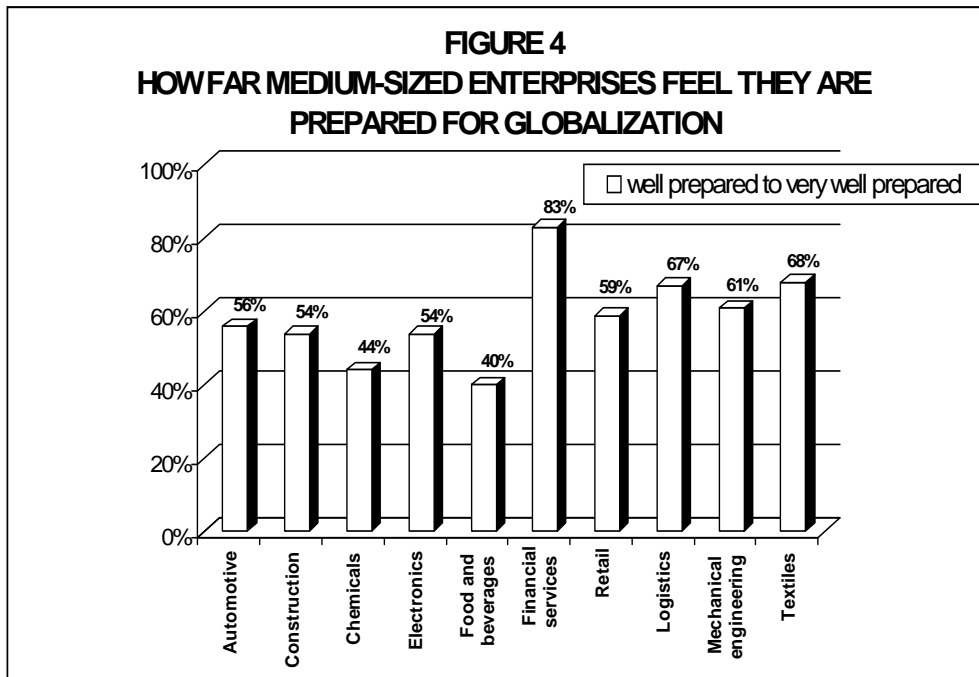
If we assume that most of the companies involved in globalization also see this as a great future challenge, then the question necessarily arises as to whether the medium-sized enterprise is equal to the tasks involved. There was a range in responses to the question of how far the medium-sized companies feel they are prepared for globalization (Figure 4).

Medium-sized companies do not feel uniformly well prepared for the future challenges of globalization in all of the sectors of industry involved. Rather, a heterogeneous picture has evolved extending beyond individual sector limits. Companies in the financial services and textile sectors appear to be well prepared for globalization (83 % and 68 %, respectively), probably as a result of the historically strong degree of internationalization in these fields. The responses from the chemical and food and beverage industries reflect a certain scepticism. In these sectors, only 44 % and 40 % of the companies, respectively, believe that they are well prepared to face the challenges of globalization. As a tentative conclusion we can say that almost all of the medium-sized companies believe that globalization will have an effect on their business activities, but that not all feel that they are prepared for the resulting challenges involved. It is interesting that this result is independent of the size of the individual enterprise involved. Even in the larger firms among the medium-sized companies there is a significant level of uncertainty about the effects of globalization.

This leads to the question: which internationalization strategies are the medium-sized companies adopting in order to cope with the effects of globalization. Of particular interest are the motives for and obstacles to internationalization, as seen by medium-sized German companies.

Motives behind and obstacles to internationalization of medium-sized companies

There are a number of reasons why a company goes international. These motives have already been the subject of a number of empirical studies (Zentes and Swoboda 1999, Mueller and Kornmeier 1997).



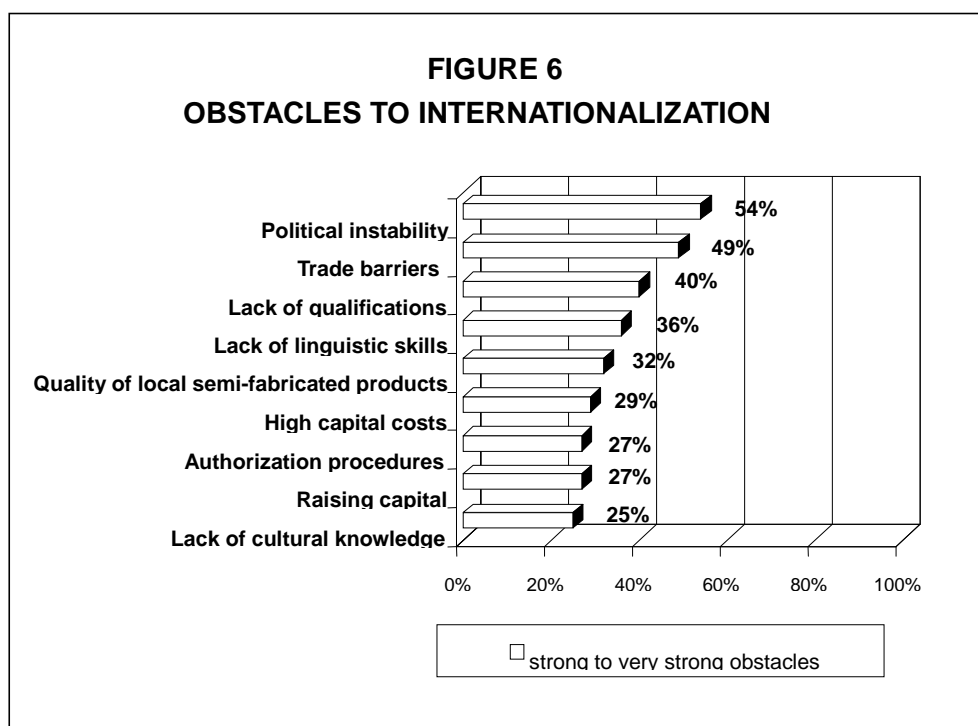
When the standard classifications in the literature are applied, we can differentiate between revenue-oriented, cost-oriented and purchasing-oriented motives. Figure 5 shows the answers supplied by the companies in the survey. Our results clearly confirm the thesis of previous studies that by far the most important motive for internationalization is revenue. The development of new markets (78 %) and the consolidation of existing markets (77 %) are the two strongest motives. The third most important, at 65 %, is to be found in purchasing cost reduction, followed by the development of country-specific market intelligence (45 %).

The remarkable point about the replies is that the development of country-specific market knowledge and of increased sales is not, as a rule, achieved through joint-ventures. On the other hand, a high correlation can be observed between the motives cited and establishment of affiliates and independent subsidiaries: companies wishing to consolidate existing markets and/or develop new ones, for the most part also establish affiliates or independent subsidiaries in the countries in question. If we examine the cost-oriented motives more closely, it can be seen that these, for the most part, involve reducing costs in purchasing. Production costs do not assume the same degree of importance. The much-debated lower production costs abroad represent a strong to very strong motive for internationalization for only 41 % of the companies. If the results of the sales and cost-oriented motives are examined in detail, the assumption is confirmed that production facilities abroad are not primarily established to make use of labor cost advantages. Rather, companies set up foreign production locations in order to create proximity to the market and, in the long term, to develop markets which already exist there. Purchasing-oriented motives play only a minor role, primarily in order to reduce dependency on suppliers (44 %) and to improve supplier quality (25 %). Tax advantages are a strong incentive to move abroad for only 17 % of the companies.

The analysis of the internationalization motives gives rise to a number of interesting conclusions, specifically (considering the sample) among German firms, about location factors. In spite of the criticism of high tax burdens and high production costs, especially of salaries and non-wage costs, these motives do not appear to be primary in the internationalization decision. On the contrary, the

medium-sized companies concentrate on a pro-active development of new markets which derives from their clear sales orientation. The problem of location factors in Germany thus contributes toward the internationalization decisions of medium-sized company only to a relatively unimportant degree.

In addition to the motives behind internationalization we also address the question of the obstacles on the path towards successful internationalization. There are a number of difficulties which medium-sized companies may encounter. Knowledge of these obstacles facilitates the development of approaches to overcoming them successfully. Figure 6 documents the obstacles to internationalization by their importance for the companies questioned.

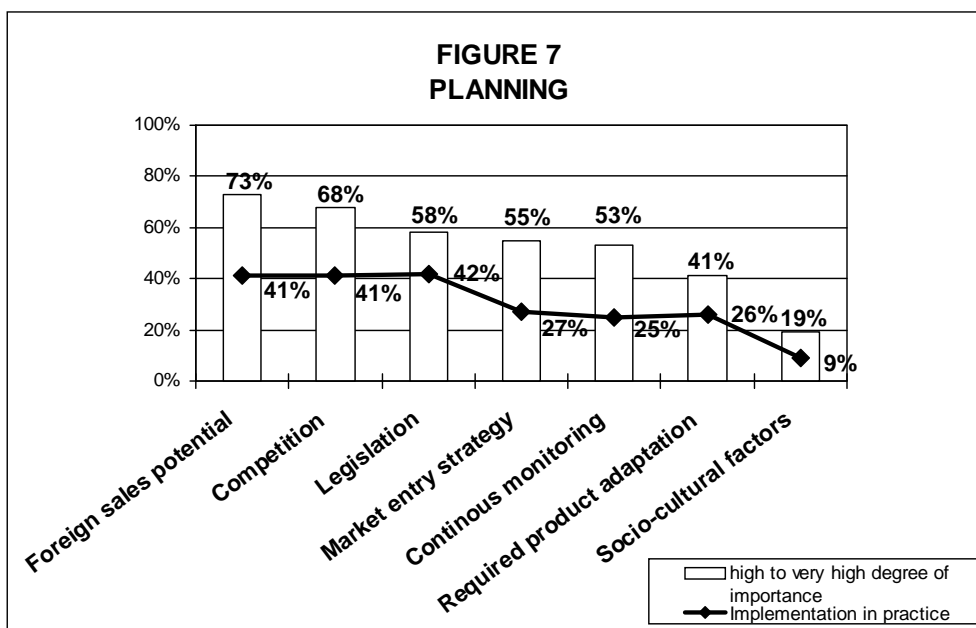


The most severe obstacles to internationalization are external and cannot be influenced directly by the company. Political instability and existing trade barriers are cited by 54 % and 49 % of the companies, respectively, as being strong to very strong obstacles to internationalization. As internal obstacles, the companies cited, in particular, lack of employee qualification (40 %), lack of linguistic skills (36 %), and lack of cultural knowledge (25 %). Problems raising capital, or the high cost of capital,

also represent major internal impediments to internationalization, but are of comparably less importance. This result is interesting in view of the preconception that the main problem of medium-sized enterprises is the acquisition of capital. It is also obvious here that there is no distribution spread of any magnitude across the various revenue clusters in the study. Acquisition of capital is seen as an obstacle to internationalization by 27 % of the smaller medium-sized companies and by 27 % of the larger medium-sized companies.

Strategic planning for internationalization

In order to cope with the numerous demands of internationalization, it would seem that targeted planning is becoming increasingly necessary. The need to deal with the obstacles to internationalization and the complex interdependencies which can arise in the course of globalization are factors which force companies to examine their future planning critically. As a first step, then, it is necessary to examine just how important certain planning activities are for medium-sized companies, and which of these planning activities they actually put into effect. Figure 7 shows an overview of the individual planning activities which the medium-sized companies regard as being important or very important. The line indicates those planning activities which are actually implemented.



In view of the importance of the sales-oriented motive, the assessment of foreign sales potential is seen by 73 % of companies as important or of great importance, the size of the company having, apparently, no influence. Analysis of the competition (68 %) and analysis of the legal situation (58 %) are regarded as significant. Still, in view of this background of sales-orientation among medium-sized companies, it is surprising that only 41 % of the companies see possible adaptation of products as of major importance. The relative insignificance of this factor is visible in all cluster group sizes (revenue and staff). Critical examination and planning of market entry strategies are rated by 55 % of the companies as important. Here, however, the size of the company has a clear influence: the scatter ranges from 50 % in the case of smaller medium-sized companies (revenue of a maximum of DM 99 million) to 70 % in the case of the larger medium-sized companies (more than DM 500 million). Some 53 % of the companies rate continuous monitoring of internationalization activities as important.

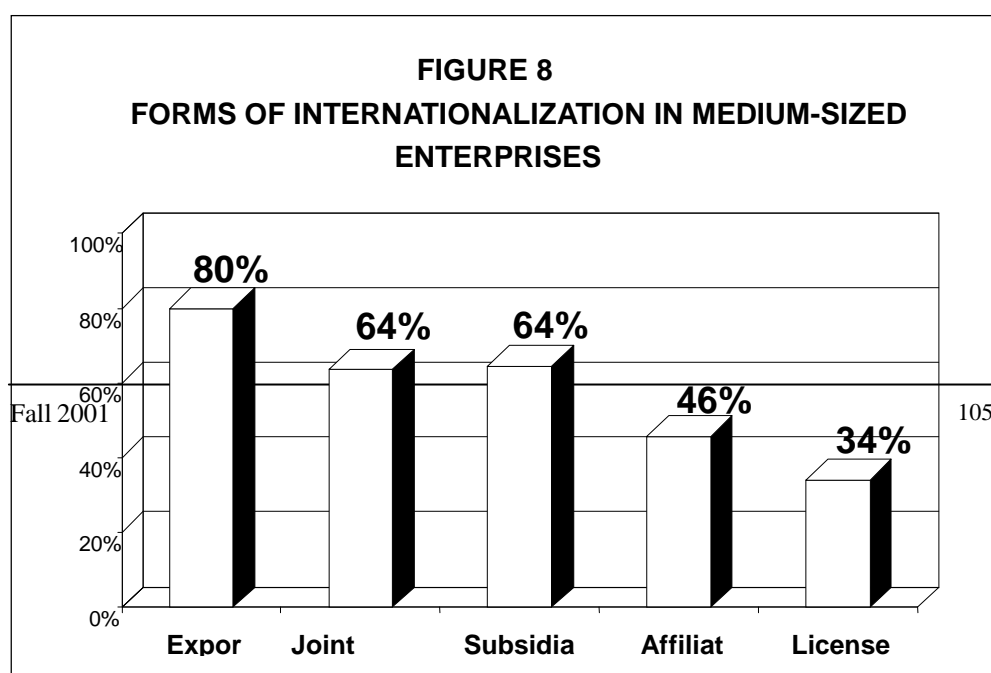
If we limit comparison to the planning which is actually implemented, we see that there are serious deficiencies in the planning conducted by medium-sized companies. Although 73 % of the companies categorize the analysis of foreign sales potential as important, only 41 % actually investigate it. Even the medium-sized companies which have a relatively large staff at their disposal (more than 1,000 employees), at 43 %, do not differ to any great extent. Discrepancies between the perceived importance of planning and its implementation can be found in all the areas under examination. The

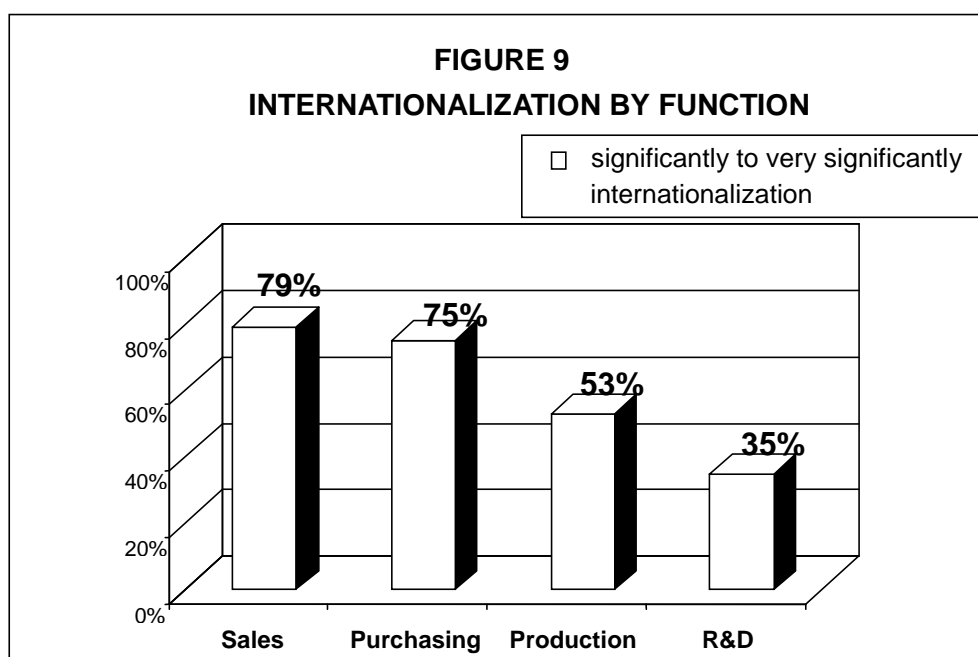
situation concerning necessary product adaptation is particularly critical. Although 53 % of the companies maintain that product adaptations are important, only 26 % of them actually examine whether or not these may be necessary. An appropriate market entry strategy also receives little emphasis: a mere 27 % of the companies carry out planning for this.

The figures for the strategic planning of internationalization clearly demonstrate that there is an enormous backlog in this area. If you look at the standard perception of German business culture, the lack of planning and data collection is unexpected. The results run counter to expectation because the German business culture is usually seen as deliberate and dominated by rational decision making processes, based on detailed strategic planning. It is true that the medium-sized companies themselves recognize the urgent need for planning. Nevertheless, increased efforts must be made in future to really implement the planning. As a rule, the medium-sized company does not have sufficient time to carry out planning processes. The burdens of daily business operations often prevent the tackling of strategic questions, a confrontation which is however absolutely necessary. This problem should not be underestimated because targeted planning is an important precondition for the success of internationalization.

Forms of internationalization in medium-sized companies

There are a number of forms of internationalization available to companies wishing to go international. In our survey we focus our attention on exports, licenses, foreign joint-ventures, foreign affiliates and foreign subsidiaries (Hodgetts and Luthans 2000, Griffin and Pustay 1998). These forms of internationalization can also be seen as stages of an ongoing internationalization process, in the sense of increasing involvement abroad (Behnam 1998a). Figure 8 shows the various modes of internationalization and the extent of their use by the companies in our sample. The data makes clear that the decision to adopt a particular form of internationalization is not an exclusive one; several forms of internationalization may occur simultaneously.





Export, with a response of 80 %, forms the core of the internationalization activities of medium-sized companies. This is to be expected in view of the German economy's pronounced export-orientation, and is confirmed in a number of other studies (Swoboda 1999, Bamberger and Evers 1997). A striking finding is that 64 % of all of the medium-sized companies in the sample have entered into at least some form of co-operation. Our results concerning the frequency of co-operative ventures among medium-sized companies differ from those obtained in other studies which find lower rates (Behnam 1998b, Koller, Raithel, and Wagner 1998). Apparently internationalization through co-operation, in particular, has been gaining in importance for medium-sized companies over the last few years. On the other hand,

at 64 %, the proportion of those medium-sized companies which have established at least one independent subsidiary is high. Here, however, there is a spread which depends on the size of the company involved. The frequency with which subsidiaries are operated rises with revenue – the larger the company, the greater the tendency to operate subsidiaries. 49 % of companies with a revenue of up to DM 50 million operate independent subsidiaries whereas the figure for companies with a revenue of DM 200-400 million is 79 % and for companies with a revenue of more than DM 500 million the figure has already reached 91 %. Licensing is relatively unimportant among medium-sized companies. Only 34 % of the companies have issued licenses for operations abroad.

Internationalization of functions in medium-sized companies

In addition to the forms of internationalization already stated we also examined the extent to which individual functions within the medium-sized enterprise are subject to internationalization (Figure 9). As expected, the strong export-oriented background indicates that 79 % of all of the companies involved have internationalized their sales activities significantly or very significantly. This result can also be explained by the dominance of revenue-oriented motives for internationalization to which we have already drawn attention. It is particularly striking that 75 % of the medium-sized companies also exhibited extensive to very extensive internationalization activities in the field of purchasing. This applies also to the smaller companies in the sample. International purchasing, in all of the clusters, seems to be important for the success of the enterprise. Among the revenue clusters a range of only 48 % to 52 % is found. As far as the internationalization of production is concerned, an analysis of the revenue clusters shows that companies with high revenue are also more involved in foreign production locations. While only 22 % of the companies with a revenue of up to DM 50 million produce internationally, 52 % of the companies with revenues of more than DM 500 million have transferred value-added activities abroad. Research and development activities of medium-sized companies usually remain in Germany. On average, only 35 % of the companies involved show a strong to very strong degree of internationalization. As only a few of the medium-sized companies actually operate large R&D departments, it is hardly surprising that the degree of internationalization in this sector is minor. Logically, the degree of internationalization in R&D appears to be size-related.

Target Regions for internationalization by medium-sized companies

In order to establish which markets are of particular interest for the medium-sized German companies, the investigation of functional business activities was combined

with a regional analysis. Table 1 shows in which regions medium-sized companies prefer to implement their chosen strategies.⁴

	<i>Purchasing</i>	<i>R&D</i>	<i>Production</i>	<i>Sales</i>
European Union	81%	37%	47%	81%
Central/Eastern Europe	40%	6%	28%	58%
North America	23%	11%	14%	41%
Central/South America	11%	2%	8%	32%
Asia	31%	4%	13%	42%
Middle East	5%	1%	4%	35%
Africa	4%	0%	4%	22%

It can be seen that the European Union (EU) plays an exceptional role in the internationalization of both purchasing and sales. More than 80 % of the companies purchase in other countries within Europe, and over 80 % also sell their products within Europe. This result makes clear just how far the integration of the European single market has progressed. The EU is the most important sales and purchasing market. Medium-sized German companies which do not expand their activities to EU partners in the long term will probably not remain viable. Doing business on an EU level can so far be interpreted as a kind of survival reaction and not as an intrinsic part of a strategic plan for growth. Our findings concerning the lack of strategic planning clearly fit into this picture.

The EU, however, plays a less important role as a location for the transfer of production facilities. Only 47 % of the companies questioned produce in other European countries. In the other regions, the degree of internationalization is most striking in sales. It is important to note here that Central and Eastern Europe (58 %), North America (41 %) and Asia (42 %) are the main targets for German sales activities. In addition to the EU, Central and Eastern Europe and Asia at 40 % and 31 %, respectively, are important as purchasing markets.

4. When interpreting the chart please note that the percentage figures cited are merely indications of preparedness for involvement in the regions listed. The extent to which companies in fact implement the activity in question in those regions cannot be directly derived from it.

RESULTS

The survey shows that internationalization among medium-sized companies is already advanced. Nevertheless a significant number of companies feel that they are inadequately prepared to meet the challenges created by increasing internationalization. One reason for this can be seen in the fact that the preferred form of internationalization continues to be exports. It is also clearly evident that both large and small medium-sized companies have, to a great extent, participated in the EU integration process which has already been in progress for years. The countries of the EU represent by far the most important markets for purchasing, R&D, production and sales. In other regions, internationalization plays only a minor role and is focused on purchasing and sales. Medium-sized companies regard political instability and trade barriers, in particular, as being obstacles to further internationalization in these regions. The focus on the functions of sales and purchasing clearly reflect the motives for internationalization, the major aspects here being the development of new, and the consolidation of existing, markets, and cost reductions in purchasing.

Our survey also shows up problem areas among medium-sized companies. There are deficits, particularly, in the strategic planning of internationalization. Although the individual planning activities are rated as being of major importance, deficiencies in implementation are evident in the everyday realities of business. Nevertheless, solutions to the problems appear to be possible. Certainly they would considerably increase the prospects of success for medium-sized German companies in their drive for internationalization.

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