THE INTERNET AND SME INTERNATIONALIZATION:
PROMISES AND ILLUSIONS

Abstract

The Internet is an important business tool and increasing traffic levels reflect this fact. It has been argued that the Internet is particularly appealing for small and medium-sized enterprises (SMEs) that wish to internationalize their activities. The objective of this paper is (1) to identify advantages the Internet offers to these SMEs, and (2) to point out some of the drawbacks that SMEs face when carrying out international transactions through the Internet. Eight propositions are developed and ideas for future research discussed.

Introduction

The Internet is an important business tool and increasing traffic levels reflect this fact. The Internet promises much for companies interested in internationalizing their business: with the Internet borders between countries are becoming less relevant and more direct interaction between business entities is made possible. The Internet is particularly appealing for SMEs, removing or reducing some of the traditional barriers they faced in doing business overseas, such as communications costs, long distances and market entry risks. Indeed, some have argued that the Internet has levelled the playing field between SMEs and global companies, giving the former a presence in all markets and ready contact with actual and potential customers, suppliers and partners abroad (Hamill, 1997). This is really important since internationalization success is mainly dependent on selection of the right foreign market and local partner, and the quality of information that guides this process is critical. Most SMEs compete with niche products and the “thinness” of markets for these products necessitates multiple market entries. The Internet has made it more feasible for SMEs to do this rapidly so as to build the critical mass necessary for success. The Internet does not only help SMEs to begin to internationalize but in helping to maintain a strong position in foreign markets through such activities as marketing intelligence, global sales promotion and inter-firm R&D (Hamill, 1997). In fact, because it is a gateway to foreign markets, the Internet enables SMEs to become international whether it was planned or not (Lituchy and Rail, 2000).

Although the Internet has many positive aspects for SMEs that wish to internationalize, it clearly cannot satisfy all of the internationalization expectations of firms. For instance, the Internet does not provide SMEs with relevant experiential knowledge about foreign markets. Much of the information available via Internet and especially on web sites constitute explicit knowledge. Hence, the Internet does not really help SMEs to penetrate the foreign markets. It does not connect the SMEs intending to internationalize to all the markets that could be profitable
for them throughout the world. Moreover, SMEs doing international business through Internet have to face many new problems.

The objective of this paper is (1) to identify advantages the Internet offers to SMEs that wish to internationalize their activities, and (2) to point out some of the drawbacks that SMEs face when carrying out international transactions through the Internet. In the process, several hypotheses are formulated that lend themselves to future empirical testing.

**Promises: Positive aspects of the Internet for SME internationalization**

**Internet and pace of foreign market entry**

The pace of the internationalization process of firms is an important characteristic in most traditional theories, even though researchers have not paid lot of attention to time spent at various stages. In the evolutionary theories, stagewise development is considered necessary so that cautious progress is made, ensuring that firms build resources, learn about foreign markets, and, thus develop a stronger capability and presence. It appears that the Internet can speed firm internationalization, particularly through reducing the costs incurred by SMEs (Petersen, Welch and Liesch, 2002). As a result, SMEs do not need to worry so much about having sufficient resources before entering foreign markets. SMEs can leapfrog early stages in the traditional internationalization process (McDougall, Shane and Oviatt, 1994; Reuber and Fischer, 1997). The extreme examples are the so-called “born global” SMEs (Knight and Cavusgil, 1996). The Internet also increases the speed of contact with many potential foreign customers. In this way, it provides SMEs with considerable information that helps to significantly reduce the uncertainties of foreign markets, even though it does not eliminate risk (Petersen, Welch and Liesch, 2002). Because the Internet provides SMEs with an opportunity to learn much faster and easier, targeting markets that offer the best chance of success should be possible. It should also be beneficial in the selection of local partners, once again because it provides SMEs with relevant information. This is particularly important when SMEs plan to internationalize through business networks rather than dealing directly with foreign customers. In some cases, the Internet will increase the pace of SME internationalization by eliminating or lessening the need for intermediaries (Quelch and Klein, 1996). Lituchy and Rail (2000) have confirmed some of these proposed effects of the Internet on the pace of the SMEs internationalization.

Thus, the first proposition is formulated as follow:

*Proposition 1:* The Internet speeds the pace of SMEs foreign market entry.

**Internet multiple foreign market entry**

The Internet provides SMEs with unprecedented opportunities to internationalize worldwide and very rapidly. A SME with a web site is in effect a global company, operating 24/7. This gives customers the opportunity of purchasing, wherever they are, whenever they want (Rosson, 2004). A distinctive feature of the Internet then is that it makes it feasible for SMEs to instantaneously position themselves on many foreign markets (Petersen, Welch and Liesch, 2002). Lituchy and Rail (2000) stated that the use of a web site propels SMEs into the internationalization process. Even SMEs that do not plan to internationalize become active overseas through the trigger of unsolicited orders resulting from the exposure provided by their web site. The instantaneous and costless interplay between SMEs and their foreign customers play an important role in internationalization success. Specifically, information resulting from such interplays often guide necessary adjustments in products, pricing or other areas that makes
market penetration more likely. Craig and Thandarayan (2000) reported in their research on
Australian and South African tourist firms that foreign marketing via the Internet failed in part
because a standard product brochure was made available when, in fact, adjustments were needed
in quality, price, language and culture. Furthermore, adjustments made by SMEs to serve one
foreign market can often be transferred where indicated to others without major costs. Such
transfers help make fast entry into successive foreign markets (Gareiss, 2000).

In light of the above, the second proposition is formulated as follows:

Proposition 2: The Internet facilitates multiple foreign market entries by SMEs

More effective entry mode choice

The choice of foreign entry mode is a critical factor for success. Root (1994) identifies
three basic approaches to entry mode choice: (1) no explicit choice of market entry mode such as
the case where SMEs receive unsolicited orders from foreign buyers, (2) a choice made in
accordance with the existing market entry strategy, and (3) a choice that considers some strategic
rules and is based on a systematic comparison of the different possible modes. The latter
approach seems more realistic, particularly for SMEs since it allows them to choose the
appropriate mode given their strategic orientation and other factors. There are many factors that
influence the entry mode choice, making this decision sometimes very hard. Koch (2001)
proposes a comprehensive model in which he identifies 16 factors as influencing the entry mode
choice. But most of these factors seem to result in one core element, namely the risk related to the
targeted foreign market. In other words, the choice of an entry mode by SMEs depends on how
they perceive the risk they face regarding the targeted foreign market. Traditionally, the perceived
risk is too high for SMEs intending to internationalize since the information needed to assess this
risk is really costly and not necessarily reliable. Hence, only big firms were able to
internationalize through equity entry modes that require sizeable investment on foreign markets.
With the advent of the Internet, the situation has changed considerably. Indeed, the Internet has
radically changed the SMEs’ traditional risk perception regarding foreign markets by providing
more information to assess this risk, and new opportunities to internationalize. SMEs can
internationalize directly from their web site by exporting without intermediaries the goods needed
by their individual customers, and by negotiating contractual agreements such as licensing, R&D
contracts or other alliances with foreign companies. For many SMEs the barriers imposed by
entry modes requiring investments, such as joint ventures and foreign direct investment can be
bypassed with the Internet. Consequently, the Internet makes it possible for SMEs to more often
choose non-equity entry modes that are flexible, have low resource requirements and, are
therefore consistent with the characteristics of most SMEs.

Thus, the third proposition of this research is formulated as follows:

Proposition 3: The Internet influences SMEs’ choice of foreign market entry mode

Building interfirm networks in foreign markets

One of the most important stages in creating interfirm networks is the search for
information on potential partners. This stage is costly for SMEs that wish to internationalize since
their limited resources do not allow them to afford higher costs related to the search for foreign
partners. With the Internet these costs have seriously decreased. SMEs can easily and quickly
have access to the information on their potential partners through the Internet. They can visit their
websites and establish contact with them costless. They can also have access through the Internet
to information regarding their past experiences in interfirm relationships and analyse whether
they can be good partners and the type of network links that can be appropriate. In other words, the Internet provides SMEs with good opportunities to establish strategic alliances (Soliman and Janz, 2003). It stimulates collaboration between organizations (Aalst, 1999), and this is particularly true for SMEs that wish to internationalize. There are both active and passive approaches for creating interfirm networks around the world. The active approach is where the SME takes the initiative, seeking out firms with whom to partner. In contrast, the passive approach is where an SME responds to the advances of other companies. The Internet can help accelerate either approach at relatively low cost, and create an atmosphere that allows the SME to prepare an easy first person-to-person contact with its partner.

Thus, the fourth proposition of this research is formulated as follows:

*Proposition 4:* The Internet helps SMEs to build interfirm networks in foreign markets

**Illusions: Problematic aspects of the Internet for SME internationalization**

**Internet market penetration is still difficult**

Much has been expected of the Internet in international business, particularly for SMEs. Unfortunately, the advantages conferred by Internet seldom meet the high expectations (Coltman, Devinney, Latukefu and Midgley, 2001). Relatively few foreign markets can be penetrated by SMEs using the Internet alone (Petersen, Welch and Liesch, 2002; Lituchy and Rail, 2000). In many cases, the foreign market success requires adjustments in terms of product, guarantees of appropriate quality of service in order to meet the customer needs or to comply with government regulations, or to match local business practices, or available distribution channels. All these adjustments need a local physical presence. Particularly for SMEs intending to sell complex products on foreign markets, trusting relationships are necessary. In the early stages person-to-person contact is needed. In fact, the success of SMEs often hangs on the acquisition of experiential knowledge. This is seldom developed through the Internet because it deals in explicit rather than tacit knowledge. Another concern with information available through the Internet can be subject to problems of adverse selection since the company’s managers are free to determine the quantity and the quality of the information placed on the web sites. This information can simply be false. A major obstacle that can limit the usefulness of the Internet concerns the language and cultural content employed in the website, the quality of the telecommunication infrastructures in various markets, access to and skill with computer systems. The content of the website should not offend customers in foreign countries. For instance little things such as requiring visitors to identify themselves as “Mr”, “Ms” or “Miss” may be perceived as insults in some countries (Peek, 2000). In conclusion, one can say that SMEs using the Internet as a sole vehicle to internationalize their activities will not be able to capitalize on much of the sales potential in foreign markets.

Accordingly, the fifth proposition is formulated as follows:

*Proposition 5:* The Internet is a limited tool for SMEs that intend to penetrate foreign markets

**The Internet creates intense global competition**

market that can be withdrawn to if global competition in foreign markets is too harsh. In sum, using the Internet to internationalize may well increase the intensity of the
SMEs that use the Internet to internationalize should accept that this will subject them to global competition. Fillis (2002) found that United Kingdom and Irish exporting SMEs experienced substantial price and promotion challenges from competitors. This was especially pronounced for SMEs that used the Internet as a main internationalization tool. Since the websites of these companies exposes them widely in foreign markets, the competition is extensive and potentially includes multinational companies with considerable market power. SMEs have to face this competition at an earlier stage of their internationalization process, when they are typically not ready for such rivalry (Sawhney and Mandal, 2000). Limited resources usually make it difficult for SMEs to match competitors’ budgets or prices. A niche product strategy often insulates SMEs from some of the fiercest competition but market penetration strategies are usually out of the question. The transparency of prices is a major aspect of the Internet that makes life difficult for SMEs. The difficulties faced by SMEs using the Internet to internationalize is more serious in the case of “born global” SMEs, because they do not usually have a solid domestic competition face by SMEs in foreign markets.

Accordingly, the sixth proposition is formulated as follows:

Proposition 6: The Internet exposes SMEs to increased global competition in foreign markets

Internet cost savings are hard to achieve

Doing business through the Internet incurs significant costs that require thorough appraisal. Contrary to the widely held view that the Internet generates costs savings, in reality these savings may not be significant and in some cases SMEs have experienced higher costs (Fattori, 2001; Heart and Pliskin, 2002). This is particularly true for SMEs doing business in foreign markets. Internet costs savings are cited to most often occur in paperwork, customer service, intermediation, and advertising and promotion. However, the importance of some of these costs savings varies with the size of the company. For instance, savings in customer service seem more likely in larger companies, whereas those related to advertising and promotion seem more significant for SMEs (Riquelme, 2002). There are a wide range of Internet costs that internationalizing SMEs have to face, including website creation (including costs of hardware and software), maintenance and updating, website translation and cultural adjustments and ongoing specialized staff costs. Building a website can be a costly undertaking depending on the complexity of the site planned. In 1999, the median cost for web site development was US$37,000, reaching US$200,000 for a complex site with transaction capabilities. Adding a foreign language capability ranges in cost from US$10,000 to US$500,000 (Wilson and Abel, 2002). Continuous updating and improvement is necessary in order to keep the interest of customers and maintain a competitive edge, and this adds further cost. Internet cost saving is not assured for SMEs, given the investments needed on a continuing basis. Walczuch, Braven and Ludgren (2000) found that Dutch SMEs that used the Internet in their business transactions did not experience lower costs or greater efficiency. These findings are supported by Riquelme’s (2002) study of large and small businesses in China. Thus, the Internet does not necessarily meet the cost-effectiveness expectations of internationalizing SMES.

Accordingly, the seventh proposition is formulated as follow:

Proposition 7: The Internet exposes internationalizing SMEs to higher operating costs
Internet legal issues persist

The laws that govern international transactions are those developed for the traditional trade of physical goods and services. Since these laws are still in effect, they have been applied to cover international transactions through the Internet even though these laws are not necessarily appropriate. The use of the Internet by companies involved in international trade raises a wide range of legal questions for which there are few answers at present. Relevant questions include: How can the owner of an Internet home page take steps to ensure that he/she will not have to defend a lawsuit in a foreign court? (Mykytyn, 2002). If a dispute arises between parties in different countries, which country laws should apply? Those of the plaintiff’s country, or those where the defendant is based? And, what will happen if the laws conflict? (Newman, 2003). Does the electronic contract on the website of the company have precedence over the laws that govern transactions in the country of the customer? Since having a website makes the company a de facto global company, 24/7, should the company have to comply taxes (income tax, consumption tax, value added tax, etc.) in the countries of its customers?

In light of these questions, It is no exaggeration to think that companies doing international business through the Internet are exposed to many important risks. Legal conflicts can arise at any time and involve large litigation costs. For SMÉs with limited resources, the risk of bankruptcy from a legal challenge is real. SMEs can adopt various strategies to deal with these concerns. Specifying in advance the laws that will govern the Internet related transactions is one of these strategies (Haapio, 2001). SMEs should be self-protective, proactive and preventive in the clauses included in electronic contracts in order to avoid an entanglement in legal troubles. While this strategy can be helpful in certain respects, it is not a panacea. SME managers and their counsels cannot anticipate all the legal issues that can arise with their international transactions through the Internet, since as humans they are characterized by limited rationality. As well, by inserting many preventive clauses in a contract customers might be lost, since they might lack confidence in the company or consider that all the risks are on one side. Further, it is an illusion to think that agreement on the part of the customer rules out legal troubles. For instance, clauses in an electronic contract might be agreed to by the customer yet contradict the law in the customer’s country. The vast majority of jurisdictions have not yet decided that clicking on “I agree” constitutes an enforceable agreement, although legal opinion seems to be trending in that direction (Weeks and Smith-Frisone, 1999). Other strategies that internationalizing SMEs can adopt are to either forego international transactions through Internet or to limit them to foreign markets which legal systems are very similar to those in their own country (Newman, 2003).

These different strategies show the extent to which legal issues can seriously limit the SMEs business expectations on foreign markets when the Internet is employed. In an attempt to overcome these problems, national and international institutions are attempting to harmonize legal systems. But efforts in this are making slow progress. This is hardly surprising insofar as the legal system of a country is strongly rooted in its culture and represents an aspect of nation’s sovereignty. The result is that SMEs doing business through the Internet are exposed to potentially serious legal issues with very costly consequences

Accordingly the eighth proposition is formulated as follow:

Proposition 8: Legal issues in foreign markets limit the influence of the Internet on SME internationalization
Discussion and research agenda

The Internet and internationalization: false expectations?

The Internet revolution reminds us of what happened when Gutenberg invented the printing press in 1450. This invention raised many expectations, many of which were not satisfied, including an end to illiteracy. The development and application of the Internet has similarly raised huge expectations that are difficult to realize. In other words, many of the benefits have proven to be illusory.

The Internet has certainly changed many business practices and provides opportunities to companies, particularly SMEs for whom international business looked more of a dream than a reality. Indeed, internationalizing SMEs can benefit from low communications costs, real time communication around the world, simultaneous exposure to many foreign markets, and e-
commerce. But these advantages generally hide many problems related to doing international business through the Internet. Except for standardized products or commodities, the Internet has not been able to replace the person-to-person contact generally required to build the necessary trust for successful international transactions. For many products the Internet cannot replace physical distribution channels. Moreover the Internet exposes SMEs to global and greater competition, particularly regarding price. For instance, among SMEs selling books, music and software, the only ones that will stay in business while competing on price, are those that can achieve high economies of scale (Wilson and Abel, 2002). The Internet raises many problems of security that make consumers overcautious and seriously limits potential. Contrary to the widely held view that the Internet will allow SMEs to sell anywhere in the world, as a tool of international business, the Internet offers the greatest potential in the triad of North America, Europe and developed Asia. Most developing countries do not have the required Internet technology to be markets or suppliers at this time.

The failure of theory to explain Internet internationalization by SMEs

Traditional and dominant theories of the internationalization of firms fail to explain the process followed by many SMEs today, particularly those doing business through the Internet. The theory of foreign direct investment does not seem appropriate to SMEs with their limited financial resources. Evolutionary theories that view internationalization to involve a gradual and incremental process have achieved wide acceptance in the literature and better represent the possibilities that face SMEs (Johanson and Vahlne, 1977). Cavusgil (1980) proposes something similar, internationalization as a process going from pre-export involvement to active export involvement, and then committed export involvement. However, a potential drawback of evolutionary theories is that they were developed before the Internet became a fact of business life. Employing Internet technology means that today’s SMEs do not necessarily move through a stage-wise internationalization process in a cautious manner. The Internet has accelerated learning about foreign markets. The last approach to firm internationalization is the network perspective, which holds that through collaboration, non-competing firms can share knowledge and resources and, in the process, position themselves on foreign markets quickly (Etemad and Wright, 1998). The network approach is particularly relevant for SMEs when they have specific advantages that are seen as complementary and non-competitive by a foreign partner. The limit of this approach is that, as with the other internationalization theories, it was developed before the Internet boom and fails to explain how this technology can be incorporated with the internationalization process.

In short, a new theory of firm internationalization that considers the realities of the Internet and the characteristics of SMEs, is needed. Further research is also needed to better understand the impact of the Internet on internationalizing SMEs. Few empirical works have been undertaken that systematically examine this subject. It would be also interesting to check on the extent to which the Internet has helped SMEs from developing countries to internationalize.
References


