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Export Behavior of Service Sector SMEs

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Export Behavior of Service Sector SMEs

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Abstract

Export is vital for almost any sector in the economy. Most research on SME export behavior is carried out in the manufacturing sector. In this article, however, the scope is broadened from the manufacturing sector to the service sector: which problems do SMEs in the service sector face when doing business abroad?

In addition, the study involved a comparison with domestic activities. Normally, research on SME export behavior is directed at profit and risk only. In this paper, however, profit and risk perception in the context of international activities is also compared explicitly with domestic activities.

The exporting SMEs dealt with in this paper experienced higher profits and lower risks than their non-exporting counterparts thanks to exporting. These conclusions about the service sector confirm research in the manufacturing sector and suggest that exporting SMEs are a homogeneous group that do not reflect the classical dichotomy between products and services. Furthermore, export profit and risk perception in an absolute sense are similar to export profit and risk perception in relation to domestic perception.

Introduction

The purpose of this paper is twofold. First, we want to analyze whether perceptions in the context of internationalization of small and medium-sized enterprises (SMEs) in the service sector differ from those in the manufacturing sector. Second, we want to analyze whether export profit and risk perception in an absolute sense differs from profit and risk perception in relation to domestic activities.

Export and internationalization are vital for almost any sector because of their tremendous potential for enhancing sales' growth, increasing efficiency and improving quality. Much research has already addressed the specific problems that SMEs in the manufacturing sector face when they extend their operations across national borders. The international involvement of SMEs in the service sector has yet to be covered extensively. Therefore, the scope of this paper has been broadened to include the service sector: Which problems do SMEs in the service sector face when doing business abroad? In addition covering general questions about risk and profit associated with international activities the study involved a comparison with domestic activities. Internationalization behavior is not examined exclusively according to whether or not the SMEs are involved in export trade but is treated as a process, for which we used the so called stages model.

The exporting SMEs dealt with in this paper experienced higher profits and lower risks than their non-exporting counterparts thanks to their international business. These conclusions (concerning both international activities in general and compared with domestic activities) about service firms confirm research in the manufacturing sector indicating that exporting firms perceive higher profits and reduced risks from foreign activities. Based on this research project, additional attention is recommended for the non-exporting SMEs involved, especially with respect to trends in their profit and risk perception and possibilities for export collaboration.

The Stages Model: A Summary

According to the stages model, which has dominated recent SME export literature, a firm passes through various stages before reaching maturity in its foreign activities. In each successive stage, commitment to international activities increases as entrepreneurs learn more from the international market and gain experience. The different stages may, however, be identified in several ways.

Calof and Viviers (1995) found that the more advanced the manufacturing firm's stage in export intensity, the lower the costs and risks of exporting and the greater the benefits derived. These advantages are confirmed by Karagozoglu and Lindell (1998): the most important motive for technology-based SMEs to internationalize was the fact that global market opportunities appeared more promising than those on the domestic market. The second most important motive for internationalization consisted of inquiries from potential foreign buyers. Karagozoglu and Lindell (1998) mentioned the following most important barriers to internationalization: difficulties in forming international partnerships, lack of managerial experience and competence to take advantage of international business opportunities and difficulties in gathering information about the global markets, technologies and competitors.

During the early internationalization stages, firms will find exports less profitable and more risk-filled than later on in the internationalization process. Therefore, exporting might be regarded as a learning theory of internationalization. Calof and Viviers (1995) define a firm's export intensity according to the share of exports in total sales.

Bijmolt and Zwart (1994) suggest regarding the percentage of sales exported as an indicator of internationalization. They mention satisfaction with exporting, growth in export performance and relative profitability of exports as standards for measuring export success. They base their suggestions on their research in industrial sectors.

Johanson and Wiedersheim-Paul (1975) used a comparable stages model (known as the establishment chain) for their production firms. Here, the exporting firms evolve through four stages: (1) no regular export activities, (2) exporting via independent representatives (agents), (3) establishment of a sales subsidiary and finally (4) production in a foreign country.

This gradual internationalization typology is based on different measures of involvement and is a common reference among businesspeople. There are two important aspects about the involvement: the four stages require progressively larger resource commitments (mainly internally oriented), and each one entails quite different market experiences and information for the firm (mainly externally oriented).

Reid (1981) presents the export process in general (export entry and expansion) as an adoption of innovation-type behavior in five stages:

- (1) export awareness (opportunity recognition, arousal of need);
- (2) export intention (motivation and expectancy of export contribution);
- (3) export trial (own experience from limited exporting);
- (4) export evaluation (results from engaging in export);
- (5) export acceptance (adoption or rejection of exporting).

Ogbuehi and Longfellow (1994) added time to this stage model: differences in perception were to be determined by the duration of the firms' involvement in exporting. Firm size appeared to be an important indicator of export experience. Their focus was on manufacturing SMEs.

Moini (1995), however, asserted that management expectations (concerning export profits, risks and costs) of manufacturing firms were irrelevant to export success. The primary determinants of export success were found to be the firm's competitive advantages and its willingness to seek out foreign markets. He explains these deviating outcomes by distinguishing three classes of exporters (i.e. partially interested exporters, growing exporters, and successful exporters) instead of comparing only exporters and non-exporters. He further observes that past studies focused mostly on external (demographic) correlates of export propensity. One of his suggestions for further research is to investigate the industry bias by examining other industries and other regions. In this paper the other industries examined are in the service sector; the review of regions consists of a study of SMEs from the Netherlands. Later Moini (1998) mentions the importance of acknowledging that SMEs are not a homogeneous group and may encounter different opportunities for engaging in successful exporting.

According to Kedia and Chhokar (1986), significant impediments to export activity among the firms they studied (machinery manufacturers and food processors) vary according to the respective firm's stage in the export process. While informational barriers dominate the decisions as to how and where to export, financial and marketing ones prevail once firms are already exporting. In addition to their analysis, a transition may occur from purely informational barriers to purely financial and marketing ones. As a result, different educational and export-promotion programs are required to address the needs of firms at different stages in the export process.

Adequate supply information about exporting is an important factor in completing the current stage in the export process (Weaver and Pak, 1990). This is confirmed by Leonidou (1990), who revealed that limited information for locating and analyzing foreign markets was the greatest impediment to exporting. Bell, Murray and Madden (1992) envisioned the accumulation of "exportise" by forming a contingent of skilled managers able to benefit from opportunities in international markets.

Burton and Schlegelmilch (1987) stress - with their survey of mechanical engineering and food processing firms - that increasing export involvement coincides with changes in specific variables representing organizational, managerial and attitudinal characteristics. Non-exporters reveal a rather pessimistic attitude to the risks, costs and obstacles associated with exporting. Reid (1981) emphasizes the importance of information-processing in export behavior.

See also Leonidou and Katsikeas (1996) for an overview of the most important export development models. Their conclusion is that - despite differences among the various models - export development comprises three general phases: pre-engagement, initial and advanced. In the pre-engagement phase firms are primarily involved in their domestic market. During the initial phase, the firms begin exporting. Regular exporters (with international experience and commitment) form the backbone in the advanced phase. Johanson and Wiedersheim-Paul (1975) have stressed the importance of gradual internationalization.

Although their definition of stages may differ, most researchers admit that attitudes and experiences are thought to bring about a new stage in the perception of export costs, risks and profits. Measuring the degree of internationalization at the micro level, however, can be speculative and arbitrary (Sullivan, 1994).

The stages model is not intrinsically a new approach. Greiner (1972) presented a model of organizational development comprising different growth phases. Churchill and Lewis (1983) applied this general approach to SME development, presenting five stages of growth: inception, survival, growth, expansion and maturity.

Scale

Scale can be an important determinant for export behavior: Calof (1994) found that a firm's size is related to its propensity to export, choice of export countries and export attitudes but is also of limited importance. Bonaccorsi (1992) confirms this finding when stating that small size is not a disqualifying factor, as does Philp (1997), who has stated that constraints arising from being small or very small are surmountable.

So firm size is not always a barrier to internationalization, although it can be a constraining factor (Katsikeas, Deng and Wortzel, 1997). Calof (1993) has shown that size limits only the number of markets to be served and the number of countries in which the firm is active. His research was focused predominantly on electronics and electrical supply companies. Attitudes and experience drive a firm towards the next stage in internationalization.

Destination Countries

Furthermore, researchers have found that commencing export activities have geographical and socio-cultural ties. For example, for many Canadian firms the first export market is the United States. Over time, firms extend their geographic scope to other countries.

These countries are more remote both geographically and psychologically. In becoming more experienced exporters, entrepreneurs and their personnel become less suspicious of unfamiliar destinations. Calof and Viviers (1995) confirm this in their examination of current South African exporters. The dominant destinations for South African exports were not other African markets but the European and Asian markets, which were psychologically and culturally more similar. This observation correlates with Anderson and Coughlan (1987), who mention that American firms are more likely to integrate distribution channels in Western Europe than in Japan or Southeast Asia, which are more culturally dissimilar. Erramilli (1991) finds that service (...) firms tend to choose markets that are culturally less similar to those in their home country, as doing so increases their export experience and enhances its geographical diversity. Capital intensity and scale play important roles in this context (Erramilli and D'Souza, 1993): in industries with low capital intensity, smaller firms are as likely as their larger counterparts to enter culturally distant markets, while in industries that are more capital intensive, small service firms are less likely than their larger counterparts to enter culturally distant markets. See also Kutschker and Bäurle (1997), who stress that geographic and cultural differences between countries

are among the main factors influencing strategic internationalization. Apparently, reduction of uncertainty is an important driving force in market selection.

Distribution Channels

Selection of the right distribution channel is another issue but is not an explicit focus in this paper. Anderson and Coughlan (1987) indicated that their semiconductor companies chose a distribution channel associated with the degree of transaction specificity of assets in the distribution channel, regardless of whether the product being introduced was highly differentiated. Berra, Piatti and Vitali (1995) concluded that the international growth of SMEs (in the Italian clothing industry) occurs more through contractual agreements than through non-cooperative operation. Kaufmann (1995) has reported that SMEs used distribution co-operation rather than production co-operation in order to expand into foreign markets and improve their international competitiveness. The growth of business format franchising is an important sign in this context (Shane, 1996). See also Welch, Welch, Young and Wilkinson (1997), who stressed the importance of networks in export promotion.

Hypotheses

Remarkably, most of the research has been done in the manufacturing sector (see also Coviello, Chauri and Martin, 1998). Very few export studies in the service sector focus mainly on multinationals and not on SMEs (O'Farrell, Wood and Zheng, 1998). Sullivan (1994) suggests incorporating SMEs and service companies in the refinement process of internationalization research.

Although the stages model offers great promise, it is not a panacea. The literature review reveals, however, that development stages play an important role in the export attitude and behavior of exporting SMEs. The profitability and risks associated with exports are especially crucial. The most frequently used quantitative criteria are export as a percentage of a firm's total sales and the number of years the firm has engaged in exporting. The service sector has been addressed specifically in very few cases. Therefore, the next hypothesis reflects the current literature:

H1 SMEs with more export experience perceive more profit opportunities in exporting than SMEs with less export experience.

H2 SMEs with more export experience perceive fewer risks in exporting than SMEs with less export experience.

The destination countries will also receive consideration, as the literature review indicates that greater experience with international activities is associated with geographic and psychological distance.

Data Collection

The data come from the 1996 annual benchmark survey of BNA architecture firms in the Netherlands. The approximately 1,500 member firms of the Dutch architecture organization the Royal Institute of Dutch Architects BNA (see <http://www.bna.nl/>) all received a written questionnaire. Of these architecture firms, 334 participated voluntarily in the 1996 survey, yielding a response rate of over 20 percent. Larger firms dominate the sample, and the share of typical small firms is rather small compared with both the national and the BNA populations. This response rate is not very high but nevertheless has some validity. Previous annual surveys have yielded extensive information about the Dutch architecture sector. Approximately 2,000 architecture firms operate in the Netherlands.

Dutch architecture is a typical small business sector. In the 1996 sample the average firm had a staff of 11.0, of whom 15 percent consisted of active owners, directors and involved family members. Most architecture firms operate locally or regionally. These criteria tie in closely with the definition of SMEs used by D'Amboise and Muldowney (1988), namely enterprises that are independently owned and operated and are not dominant in their field of operation.

BNA advises starting exporters to collaborate with local foreign firms to surmount cultural barriers and to compensate for their lack of local knowledge. This recommendation follows Acs *et al.* (1997), who suggest using existing distribution channels to circumvent national entry barriers.

Architects (the Greek word *architekton* refers to the function of principle builder) are typical service providers. They are primarily responsible for the design, construction, and placement of buildings and play a key role in managing the construction process. Because the services provided by an architect embody the four typical characteristics of services (i.e. intangibility, heterogeneity, inseparability and perishability; Parasuraman, Zeithaml and Berry, 1985), architecture is considered a typical service (Lovelock, 1991).

A service is not simply a product and can even be totally different from a physical product. Rushton and Carson (1985) support a subtler point of view: the most important difference between goods and services is that services are less tangible. Then the question arises as to whether this intangibility influences the way a product is handled. According to the authors, intangibility has a profound effect on this process. Fryar (1993) mentions that the differences between services and products affect marketing as well as communication.

Leonidou and Katsikeas (1996) suggest the transfer of appropriate theoretical insights gained from allied marketing domains as an alternative subject for research about export development processes. Erramilli (1991) speculates that service firms might have an advantage over manufacturing firms in the internationalization process because their overhead is lower and therefore their establishment of an overseas branch less risky. He states, however, that "all this is speculation at this stage warranting empirical validation by future research". This observation indicates this paper's relevancy: which problems do SMEs face in the **service** sector when doing business abroad? The possible direction of the answer to this question is unclear, since receipt of the four aspects of services on the one hand and exporting attitudes on the other hand have yet to be addressed thoroughly.

Although architecture is a typical service industry, the extent to which architects are representative of the service sector as a whole or even of the sector of professional

services cannot be indicated. Moreover, the sample is drawn from a Dutch industry and generalization therefore not fully warranted.

Result Analysis

Fourteen percent of the firms in the sample are involved in exporting (i.e. they derived at least one percent of their 1996 sales from activities abroad). The export ratios (export sales \div total annual sales) vary from one to eighty percent. Only two percent of the total sales of the firms in the sample come from activities abroad.

Note the question as to whether the firms earned money from activities abroad. This definition could deviate from export activities as such because the activities abroad may be paid by fellow countrymen. Furthermore, activities within the Netherlands may be funded by foreigners. This deviation is assumed to be unimportant.

The conditional average (only for the exporting firms) amounts to 13 percent. Mainly the larger firms are involved in exporting: the staff size at the exporters averages 14.0 as opposed to 10.7 at the non-exporting firms. Note, however, that staff size deviations within the two subgroups are rather large (standard deviations of 15.5 and 21 .0, respectively).

The exporting firms had higher labor productivity (i.e. sales per person, which is the main economic performance measure in Dutch architecture). This ranking is influenced, however, by the tendency of larger firms to have higher labor productivity than smaller firms and of exporting firms to be larger than non-exporting firms.

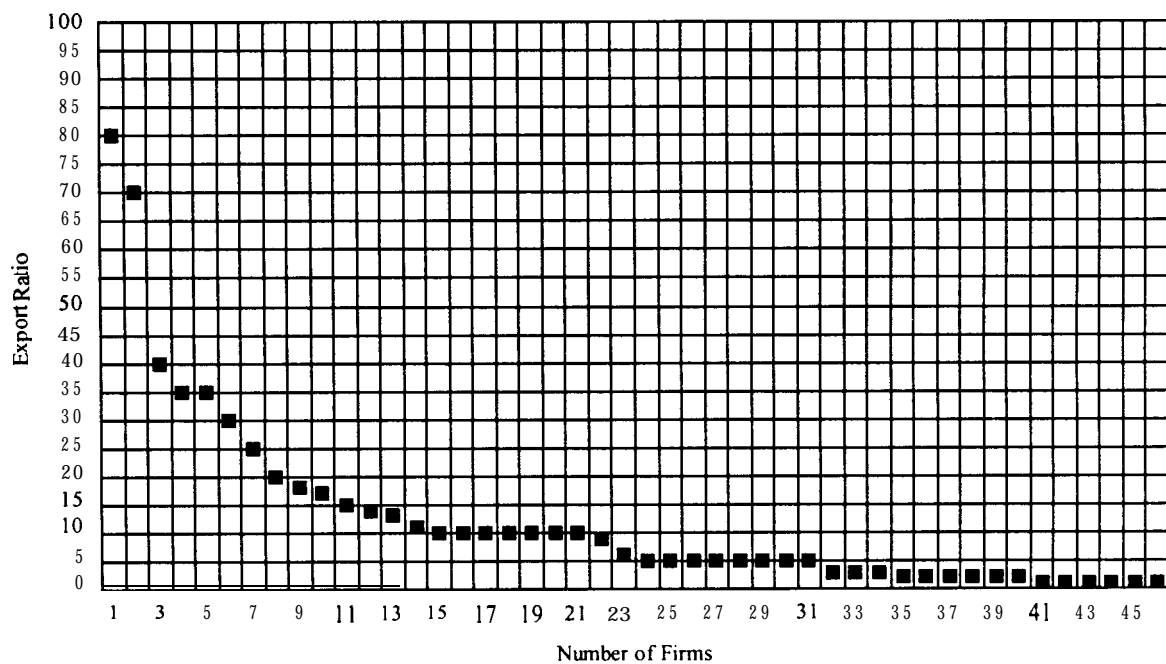


Figure 1

The main export countries are neighboring Belgium and Germany, which are culturally quite similar to the Netherlands (mentioned by almost three quarters of the exporting firms). These countries are also the only ones that physically border on the Netherlands.

Most other export countries (of minor importance) are in the European Union, such as France and Denmark.

Most firms entered the international market only recently, as Figure 2 indicates. More than half the exporting firms delivered their first order abroad within the last four years.

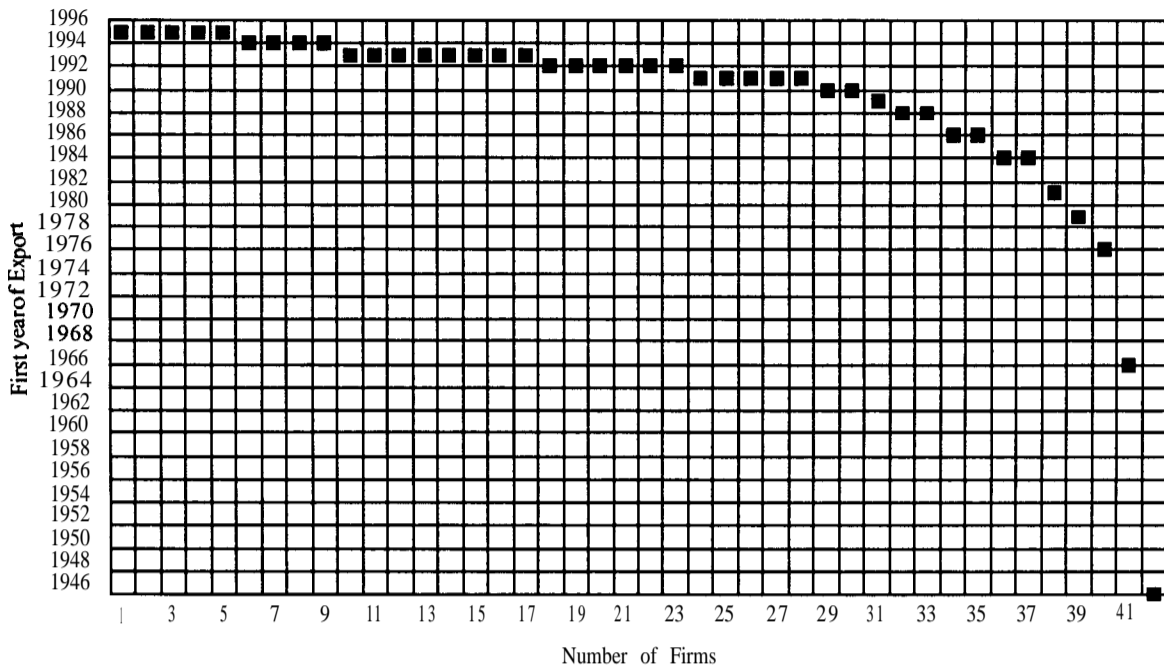
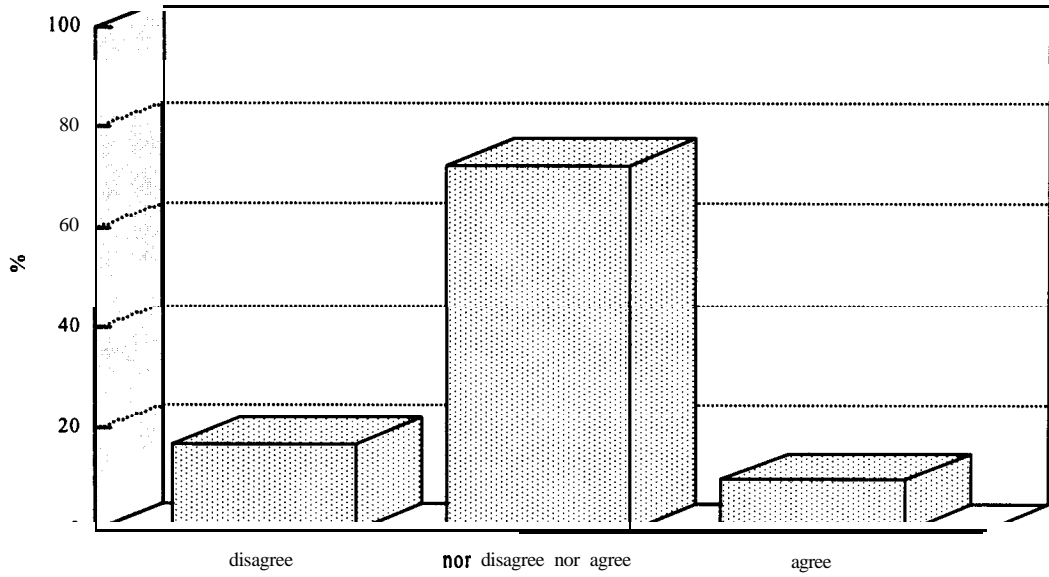


Figure 2

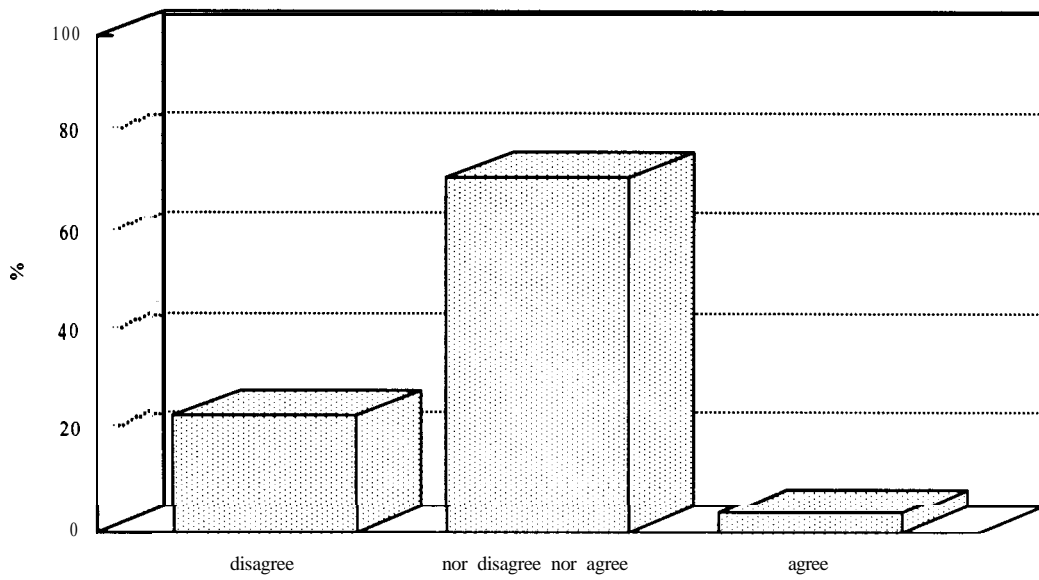
The perception of risks and profits involved with exporting are important issues, as the stages model shows. Leonidou, Katsikeas and Piercy (1998) call these subjective-specific factors, containing characteristics associated with the perceptions, attitudes, and behavior of the decision makers.

The perceptions of the entrepreneurs from this service sector are presented in Figure 3a. Clearly, most entrepreneurs lack an explicit opinion about the profitability of international activities: almost three quarters neither agree nor disagree with the opinion. Nearly 20 percent thinks that foreign activities are not profitable, whereas only a small minority (10 percent) believes that exporting is profitable.



International Activities are Profitable

Figure 3a



International Activities are More Profitable than Domestic Activities

Figure 3b

We also asked whether international activities were more profitable than domestic ones (see Figure 3b). The main differences are that more respondents regard international activities as being no more profitable than domestic ones, whereas fewer respondents judge international activities as being more profitable than domestic activities. Apparently, this question resulted in roughly the same pattern of answers.

Over half the respondents thinks that foreign activities are risky; most of the other half has no specific opinion on this matter. A very small minority does not perceive exporting as risky. Notice that the pattern in Figure 4a is quite different from the one in Figure 3a. Generally, international activities are viewed as being hardly profitable and entailing considerable risks. The answers to the question about whether international activities were riskier than domestic ones yielded virtually no differences, as Figure 4b indicates.

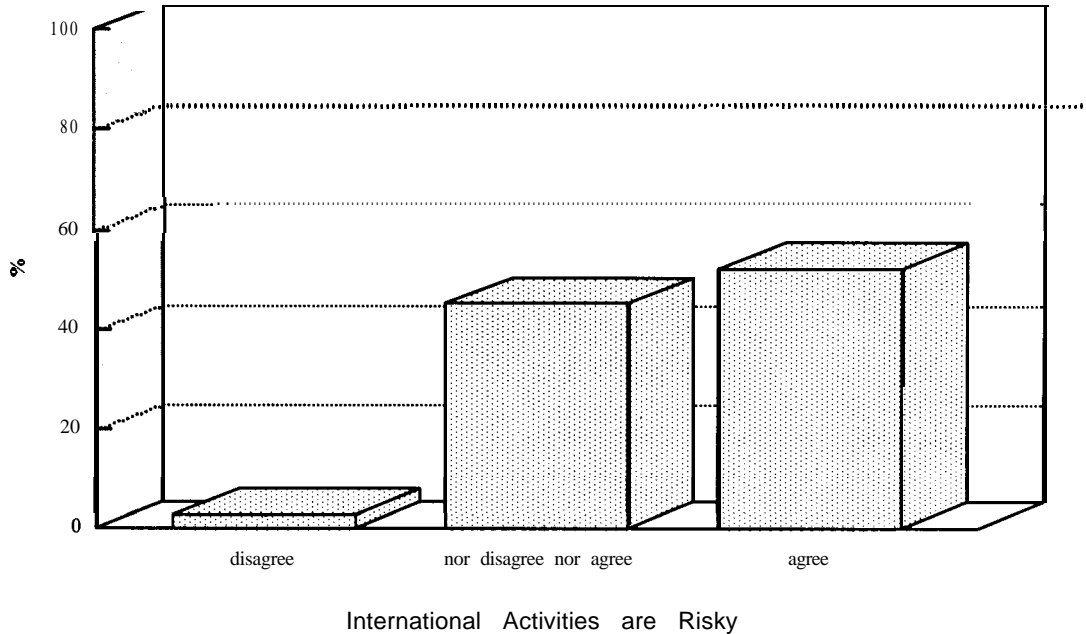
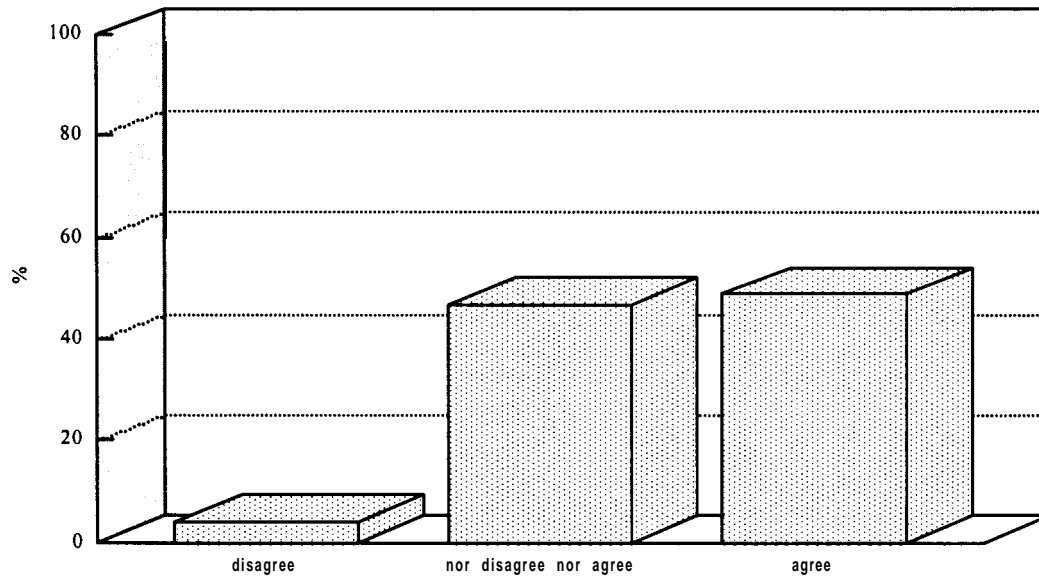


Figure 4a



International Activities are Riskier than Domestic Activities

Figure 4b

The concepts “profitable” and “risky” are rather broad and vague. Nevertheless, the overlap between the outcomes concerning “profitable” and “more profitable than domestic activities” is telling. The same holds true for “risky” and “riskier than domestic activities”. For a further operationalization of uncertainties faced by firms with international activities, see Miller (1992) and McGrath (1999).

Testing

First, the group of architecture firms was divided into non-exporting and exporting firms, based on whether the export ratio was zero or greater than zero. The group of exporting firms was then subdivided into those deriving less than five percent of their total sales from international activities (small exporters) and those deriving more than five percent from such activity (large exporters).

The cut-off point of five percent is chosen quite arbitrarily but as such has hardly any influence in comparison with other cut-off points. In this way we hope to avoid a rigid distinction between exporters and non-exporters.

Table 1a reveals that the entrepreneurs of the exporting SMEs tended to experience greater profit opportunities from exporting than the entrepreneurs of the non-exporting SMEs. This is hardly surprising in general but does shed new light on the service sector. Nearly 40 percent of the exporters perceives foreign activities as profitable, as opposed to only four percent of those from the non-exporting firms. Another important addition to the χ^2 value comes from the exporting SMEs: only a relatively small subgroup lacks an explicit opinion regarding the profitability of international activities.

Table 1 b indicates that the same holds true for international activities in comparison with domestic activities: exporters perceive profit opportunities more frequently. Remarkably,

however, exporters are also more likely to disagree with this statement, possibly because of the tremendous percentage of non-exporters with no opinion about the difference in profitability. Generally, the owners of exporting SMEs perceive more profit opportunities in international activities than non-exporters do.

Table 1 a. International Activities are Profitable

| | Disagree | No opinion | Agree | Total |
|---------------|-----------------|-------------------|--------------|--------------|
| Exporters | 9 | 19 | 18 | 46 |
| Non-exporters | 33 | 164 | 8 | 205 |
| Total | 42 | 183 | 26 | 251 |

χ^2 (df = 2) **53.0**
99.9%

Table 1 b. International Activities are more Profitable than Domestic Activities

| | Disagree | No opinion | Agree | Total |
|---------------|-----------------|-------------------|--------------|--------------|
| Exporters | 19 | 21 | 6 | 46 |
| Non-exporters | 44 | 159 | 3 | 206 |
| Total | 63 | 180 | 9 | 252 |

χ^2 (df= 2) **25.4**
99.9%

The comparison between small and large exporters failed to yield reliable results, as the subgroups were too small. No clear relationship is apparent between the number of years a firm has been involved in exporting and the perceived export profitability. Nor do firms exporting to neighboring countries (Belgium and Germany) perceive any differences in profitability compared with firms exporting to other countries. The group of exporting SMEs in this sample seems too small to provide a basis for a conclusion other than that exporting firms have a higher perception of profit opportunities than non-exporting ones.

Table 2a reveals that export intensity and risk perception are also dependent variables. The main differences arise from the relatively small number of non-exporting SMEs disagreeing with the opinion that exporting is risky, the relatively large number of exporting SMEs disagreeing with the above opinion, and the relatively small number of exporting SMEs that neither agrees nor disagrees. We therefore conclude that exporting SMEs in general perceive fewer risks in exporting than do non-exporting SMEs.

Table 2a. International Activities are Risky

| | Disagree | No opinion | Agree | Total |
|---------------|----------|------------|-------|-------|
| Exporters | 5 | 13 | 27 | 45 |
| Non-exporters | 2 | 103 | 102 | 207 |
| Total | 7 | 116 | 129 | 252 |

χ^2 (df = 2) 18.0
99.9%

No clear relationship exists between export share and risk perception, nor between duration of exporting or destination countries on the one hand and risk perception on the other. Again, the small number of exporting SMEs in this sample is one of the main obstacles here.

The non-exporters perceiving international activities as risky are important here (see also Table 2b). Exporting SMEs view international activities as less risky. Thus Table 2b yields similar conclusions (compared with Table 2a).

Table 2b. International Activities are Riskier than Domestic Activities

| | Disagree | No opinion | Agree | Total |
|---------------|----------|------------|-------|-------|
| Exporters | 5 | 12 | 29 | 46 |
| Non-exporters | 5 | 103 | 99 | 207 |
| Total | 10 | 115 | 128 | 253 |

χ^2 (df = 2) 13.2
99.9%

Discussion

The first hypothesis has been confirmed: exporting SMEs from the service sector also perceive international business as more profitable than non-exporting SMEs. This view seems logical: otherwise the exporting firms · acting rationally · would not be engage in operations abroad, while the non-exporting firms · acting rationally · would do so. The novelty of this conclusion lies in the fact that this hypothesis is new for the service sector and has undergone double verification. Nonetheless, the element of ambiguity lies in the fact that the exporting firms might be expected to know from their bookkeeping and accountant's reports that exporting is a profitable business, while non-exporting firms can only surmise that exporting is not profitable (as they lack precise figures). Remarkably, the relationship between export and profit perception in general comes mainly from three (out of nine) subgroups.

The second hypothesis has also been proven: exporting **SMEs** from the service sector perceive fewer risks in international business than non-exporting **SMEs**. This conclusion confirms previous research once again. Moreover, the relationship between exporting and risk perception in general once again comes mainly from three - albeit different - subgroups. Once again, the novelty of this conclusion lies in the verification for the service sector and the double verification.

Conclusions

Exporting **SMEs** in the service sector derive relatively high profits from and run low risks connected with their international business compared with their non-exporting counterparts. This conclusion confirms previous research in the manufacturing sector, according to which exporting firms expect both higher profits and lower risks from foreign activities. The old adage “nothing beats experience” also applies in the service sector.

Contrary to the standard opinion that services are not just another type of product, we may conclude that the stages model also works for firms from the service sector, and that exporting **SMEs** seem to be a homogeneous group. Intangibility does not influence exporting (at least not in this subgroup). Exporting may therefore be viewed as an exception in the discussion about the differences between services and products.

The previous and the present research unconditionally support the opinion that exporting firms perceive more opportunities in foreign activities than non-exporting firms do. Both also agree on the difference in risk attitude between exporting and non-exporting firms. Non-exporting firms were already known to perceive foreign activities as risky and thus have an important reason not to enter the foreign market.

The analysis in this paper further shows that export profit perception in an absolute sense is almost the same as export profit perception in relation to domestic profit perception. Similar conformity was shown by the comparison between absolute export risk perception and export risk perception in relation to domestic risk perception.

Recommendations

These conclusions lead to two important recommendations. The first concerns the non-exporting **SMEs**' attitude towards foreign activities: they do not perceive exporting as profitable and consider it rather risky. Their reasons for reaching this conclusion merit investigation: are such operations not feasible for them (e.g. is their scale too small?), or are they basically “unfamiliar, undesired” (e.g. do they lack information?). Collaboration might compensate for the scale disadvantage, whereas directed information supply might resolve the information gap.

The current research has revealed that non-exporting **SMEs** are generally smaller than exporting **SMEs**. The reason for not exporting or for perceiving export as insufficiently profitable and excessively risky might concern their small scale and resulting additional vulnerability. Collaborating with other firms (small or large, domestic or foreign) is one way to compensate for this shortcoming. Additional research should indicate whether exporting **SMEs** in the service sector that engage in collaborative efforts are more successful than their counterparts that operate solo.

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