

## Internationalisation, liabilities of foreignness and learning processes: Dutch SMEs internationalising to the UK

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*“Rutte pursuing new export opportunities in London”*

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Barend Bekamp

Caption picture front page:

*“Prime Minister Mark Rutte having a conversation with his colleague David Cameron during a train journey from Birmingham to London. Rutte is visiting the United Kingdom with a delegation of CEO’s from Dutch business. [...]. Requests for participation in this trade mission outnumbered the total number of available places”* (Volkskrant, 14 November 2011, translated by the author of this thesis).

# **Internationalisation, liabilities of foreignness and learning processes: Dutch SMEs internationalising to the UK**

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*"No two countries that both had McDonald's had fought a war against each other since each got its McDonald's."*

Thomas Friedman, American author.

## Preface

This thesis is the product of the final assignment of the master Economic Geography at Utrecht University. Shortly after I started this study, I realised globalisation and particularly the increasing involvement of firms in international markets are subjects that enjoy my interest. For that reason, I decided to write my thesis about Dutch firms and processes through which they start international operations. Furthermore, my personal interest in this topic led me to search for an internship at a company or organisation that is involved in these processes.

During this search, the Netherlands Business Support Office in Manchester caught my attention. NBSO Manchester offers support to Dutch organisations that want to do business in the United Kingdom. After I applied for an internship, they gave me the opportunity to conduct an internship in Manchester for four and a half months. This proved a valuable experience for me, both from a professional and a personal perspective.

For this reason, I would like to thank Angelique Meyer of NBSO Manchester for giving me this opportunity. Moreover, I am grateful to her and Damian Willems for their assistance and support during my internship. Furthermore, their recommendations during the initial phase of the process that led up to this thesis were very helpful. In addition, I would like to thank Leo van Grunsven, my supervisor at Utrecht University. He provided me with insightful feedback and valuable suggestions which helped to improve the quality of this thesis. Finally, I would like to thank all interviewees who have taken time for the interviews I conducted with them. The information they provided me with was indispensable in the process leading up to this thesis.

With respect to the figure on the front-page; this photograph of a conversation between Prime Minister Rutte of the Netherlands and Prime Minister Cameron of the United Kingdom illustrates the importance of the economic relationship between both countries. At the foundation of this relationship are firms that engage in internationalisation processes. I hope you enjoy reading this thesis to learn more about these firms and processes!

Barend Bekamp

## Summary

In a globalising world in which national economies are gradually becoming more integrated - thereby creating an increasingly interconnected and interdependent world economy - the most important players are internationalising firms. The Dutch economy in particular relies heavily on these firms as about a third of the country's national income (excluding the public sector) originates from international firm activities. Amongst the most pivotal trade partners of the Netherlands is the United Kingdom which constitutes for 8.1 percent (€30 billion) of total Dutch goods exports in 2011 and ten percent (€9 billion) of total Dutch services exports in 2010. Exports by small- and medium-sized enterprises (SMEs) make up an important part of these exports. An interview by phone with the director of the Netherlands British Chamber of Commerce made clear approximately 25,000 SMEs operate in the UK through non-equity entry modes like agents and distributors, and about 600 Dutch SMEs have a subsidiary in the UK. These firms and their internationalisation processes are the central subjects of this thesis. For that reason this thesis' main research question is:

- **What drives Dutch SMEs to start operations in the UK, and what is the foundation of the internationalisation strategies with respect to entry-modes which these firms use?**

Firm internationalisation processes are defined by Jones (2007) as: "*a process through which firms grow and develop internationally, establish and manage their foreign operations, increase their exposure to international business through international transactions, establish and develop relationships and networks that extend across borders which is manifest and identifiable through specific entry modes, in location in relation to time*". Hence the three principal features of firm internationalisation processes are entry modes and host countries and their evolution through time. These characteristics are reflected in this thesis' main research question as formulated above.

In literature it is acknowledged SMEs are not just smaller versions of larger companies. Yet mainly due to their size, SMEs tend to interact differently with their environment. For example, SMEs often lack resources in the form of deficiencies of finance, insufficient management capacities, lack of a reputation abroad and limited access to experience and knowledge. These distinctive features of SMEs cause differences in the internationalisation processes of SMEs and multinationals. SMEs therefore require specific research attention.

A variety of internationalisation theories is distinguished in literature. The most pivotal perspectives are resource-based, behavioural, and originate in evolutionary/institutional economic geography. These theories provide the foundation of the theoretical framework on which this thesis builds.

Firms face uncertainty in their operations because of incomplete information, complexity and continuous change. As a result, firms do not act fully rational and behave more like 'satisfiers' than 'optimisers'. To handle uncertainty, firms develop organisational routines. Routines refer to the standard operating behaviour of firms and their adaptation of internal strategies to the environment. Although firms are heterogeneous in their routines, a degree of similarity is also manifested in routines because institutions - primarily on a national level - constrain economic behaviour. Institutions are defined by Scott (1995) as: "*cognitive, normative and regulative structures and activities that provide stability and meaning to social behaviour*".

Consequently, firms that internationalise have to adapt their routines to the institutional regime of host countries. The degree of difference/similarity between the regulatory, cognitive, and

normative institutions of a firm's home and host country is termed institutional distance. The larger the institutional distance between a firm's domestic country and its host country, the more a firm has to deal with a liability of foreignness. Liabilities of foreignness consist of unfamiliarity hazards, discrimination hazards and relational hazards. Unfamiliarity hazards reflect the lack of knowledge of or experience in the host country concerned, which places foreign firms at a disadvantage compared to local firms. Discrimination hazards are conceived as differential treatment by governments, firms, the general public and consumers that place foreign firms behind domestic firms when doing business. Relational hazards are concerned with the costs of internal and external organisation that all firms face. These costs are higher for internationalising firms that enter foreign countries that are unknown to them, and where they consequently have to deal with unknown actors. In order to deal with these hazards, firms must engage in internal and external learning processes, on which they can base their (business) strategies which subsequently can be stored in routines.

In order to answer this thesis' main research question, a qualitative research approach in terms of a qualitative multiple case-study was considered most appropriate. With respect to the used research method, semi-structured interviews were considered most suitable in order to get an understanding of firm internationalisation processes, as this research method enables researchers to collect in-depth, rich data. Furthermore, the use of semi-structures interviews leaves space for interaction between interviewer and interviewee which gives the researcher flexibility to ask additional questions. Consequently a database was build of Dutch SMEs which use non-equity entry modes and equity entry-modes to enter the British market. From this database, five SME which use non-equity entry-modes and four SMEs which use equity entry-modes were selected, and subsequently nine interviews were conducted.

The analysis of the interviews makes clear that SMEs do not always strategically plan their internationalisation processes. Serendipitous events and enquiries from (foreign) clients can trigger SMEs to start serving foreign markets. In these cases, the activities of Dutch SMEs in the UK are driven and shaped by an external web of formal and informal network-relationships. These reactive strategies ensure SMEs do not have to engage in extensive learning processes and consequently they avoid transaction costs. That is to say, in these cases internationalising SMEs do not have to overcome any discrimination hazards and face limited relational hazards as client requests generally originate from a firm's own network. SMEs which strategically plan foreign market entries also depend on network-partners to provide new knowledge about both markets and norms of stakeholders, in order to ensure that they face limited liabilities of foreignness. Yet network-partners often cannot provide full information about all alternatives, subsequently they drive SMEs to internationalise to markets about which they have superior information. Therefore also in these cases network-partners can be understood to guide foreign market selection and influence the pattern of market investment.

The empirical part of this thesis indicates that the internationalisation strategies with respect to entry-modes of Dutch SMEs which internationalise to the UK, in several cases also demonstrates a lack of strategic planning. With respect to SMEs which deliberately select particular entry-modes, all but one Dutch SMEs started operations in the UK started through a non-equity entry-mode. The use of local partnerships has several benefits for internationalising firms. As mentioned before, British partners - whether agents, dealers or contractual partners - can provide Dutch SMEs with market knowledge which they generally lack. Moreover, by collaborating with

British firms, internationalising Dutch SMEs are able to make use of the networks and reputations of these firms, thereby allowing internationalising firms to overcome discrimination hazards. As the start of foreign operations of SMEs is often related to activities of network-partners which' trustworthiness is perceived positively, internationalising SMEs also face limited external relational hazards.

Nonetheless, the interviews conducted in the empirical part of this thesis indicate that SMEs which operate in the UK through equity entry-modes face relatively extensive internal relational hazards. These hazards principally originate from a lack of knowledge about local (business) culture in the UK. This is caused by institutional arrangements in terms of normative and cognitive contexts which influence the common practice by which business relationships occur. Through direct personal contact and learning by doing, individuals are able to learn about local (business) culture. Hence in order to be able to operate abroad, both employees and entrepreneurs have to transcend essential cultural dichotomies, to be able to operate in different institutional environments.

The role of direct personal contact is not confined to facilitate learning processes concerned with obtaining knowledge about normative and cognitive contexts which comprise local (business) culture. Direct personal contact also facilitates the development of mutual trust which is important in business relationships between partners as it reduces (relational) uncertainty and encourages stability. Consequently relational hazards are reduced by frequent encounters between business partners.

In conclusion, the institutional distance between the Netherlands and the UK compels internationalising Dutch SMEs to engage in external learning processes with network-partners in order to reduce their liability of foreignness in the UK. This state of affairs explains the essential role of networks in host country selection processes and the preference of internationalising SMEs to use non-equity entry-modes to enter the British market. The fact SMEs that operate in the UK through equity entry-modes face relatively extensive internal relational hazards also indicates that the institutional distance between the UK and the Netherlands is relatively high.



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# 1. Introduction

## 1.1 Background: economic globalisation and internationalising enterprises

Economic globalisation is a much discussed topic, both in scientific literature and popular media. However despite this extensive coverage, people have different understandings of the term. As a result, the term globalisation comes with various positive or negative value judgements (Rodrik, 2000). This study aligns with the IFM's understanding of economic globalisation: *Economic "globalization" is a historical process, the result of human innovation and technological progress. It refers to the increasing integration of economies around the world, particularly through the movement of goods, services, and capital across borders* (IMF, 2008, pp: 1). Hence, globalisation and economic integration can be understood to describe an increasingly interconnected and interdependent world economy.

The recent wave of globalisation is characterised by increasing mobility of both factors and goods across countries and regions (Zeng and Zhao, 2009). Rising exports, increasing capital mobility and growing labour mobility are typical for this development. The major drivers of globalisation are reduced costs of both transportation and communication, and reduced barriers to investment and trade (Frankel, 2000). Herein, technological advancement, innovation and deliberative policy designs have an important role (Zeng and Zhao, 2009).

Although economic globalisation receives much attention at the moment, the world has been 'globalising' for a long time. O'Rourke and Williamson (2001, pp: 2) state: *"By 1914, there was hardly a village or town anywhere on the globe whose prices were not influenced by distant foreign markets, whose infrastructure was not financed by foreign capital, whose engineering, manufacturing, and even business skills were not imported from abroad, or whose labour markets were not influenced by the absence of those who had emigrated or by the presence of strangers who had immigrated"*. Nowadays, economic activity of all types continues to move in the direction of globalisation (Acs and Preston, 1997).

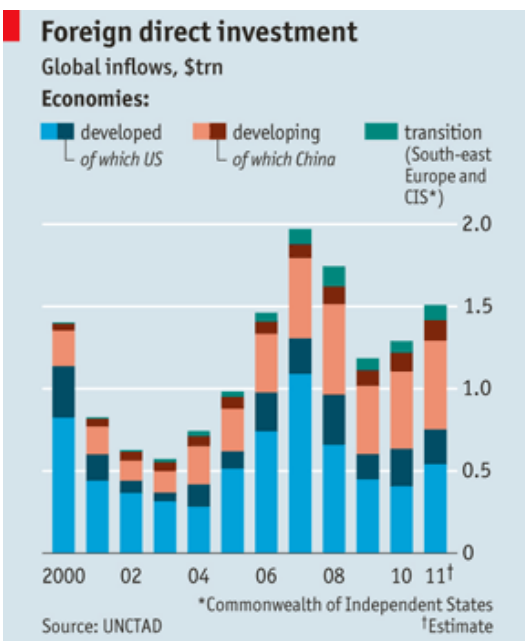


Figure 1: Global inflows of FDI  
The Economist (28 January 2012)

Greenfield and Kneller (2007) distinguish two main drivers for economic integration: cross-border trade and cross-border investment. In the annual World Trade Report, published by the Worldbank, it is made clear that after a decline of twelve percent as a result of the economic crisis of 2009, worldwide exports have risen by 14.5 percent in 2010 (Worldbank, 2011). With respect to cross-border investment, global inflows of foreign direct investment (FDI) rose by 17 percent in 2011 to \$1.5 trillion (The Economist, 28 January 2012). All in all, the levels of both cross-border trade and cross-border investment are rising again after a decline during the economic crisis of 2009. Whether this recovery will continue is unsure since the world economy is at risk, with the European debt crisis, a weak US economy and a slowdown in China (Der Spiegel, 27 December 2011).

Even though the aforementioned macro-economic statistics about international trade and investment are informative, they do not tell the whole story of internationalising firms, which are considered the key players in a globalising economy (Kleinert, 2001). Especially with respect to small- and medium-sized enterprises (SMEs), little is known about the way they participate in the global economy (Acs and Preston, 1997; Etemad, 2009). Only recently internationalising SMEs have attracted interest, because countries attempt to increase the international activities of their SMEs in order to boost economic growth, cut unemployment, and create potential mini-MNEs (multinational enterprises) in the future (Ruzzier *et al.*, 2006). But much of the international activities of SMEs remains unknown. For instance, on what grounds is their choice for a certain host country based? And how do these firms organise their international activities? Detailed answers to these types of questions cannot be deduced from macro-economic statistics. However, for governments and public agencies, information about the internationalisation process of firms can be useful since firm internationalisation can enhance the economic growth process in the host economy and raise welfare in the home economy by the provision of an additional flow of income (Barrell and Pain, 1997). Moreover, according to Hessels and Van Stel (2011), export revenues play a pivotal role in achieving economic growth in both low- and high-income countries. FDI also has positive effects on the economies of originating countries. For instance, subsidiaries can buy intermediary goods in the home country, the parent company from the home country may charge its foreign affiliates for a range of intermediate services (technical know-how, marketing information, administrative, managerial and accounting expertise), and FDI may have second-order or spillover impacts on companies from the home country (Dunning and Lundan, 2008).

This thesis is focussed on SMEs which internationalise to the United Kingdom (UK). The choice for this subgroup is principally motivated by two reasons. First, this thesis' theoretical framework, which is formulated in chapter two, discusses firm internationalising processes from various theoretical perspectives (e.g. resource-based theories and behavioural theories). It concludes with a model which is based on institutional/evolutionary economic geography in which the relationship between institutional distance and both host country selection processes (e.g. Xu and Shenkar, 2002) and entry-mode choices (e.g. Eden and Miller, 2004) is conceptualised.

In short this model entails the following conceptualisation, according to institutional and evolutionary economic geography, a firm's decisional behaviour is characterised by bounded rationality. In order to deal with uncertainty, firms resort to standard operating behaviour in the form of routines. While firms are persistently heterogeneous in their routines, a degree of similarity is also manifested in the routines of firms in certain geographical units - predominantly on a national level - as institutions constrain economic behaviour. Institutions are cognitive, normative, and regulative structures and activities that provide stability and meaning to social behaviour. Firms that internationalise have to deal with institutional differences between home and host country, and for that reason face liabilities of foreignness. This conceptualisation leads to the presumption that SMEs primarily internationalise to countries which are institutionally similar and which allow them to utilise equity entry-modes, because SMEs would face limited liabilities of foreignness in these countries.

However, the varieties of capitalism literature suggests the institutional distance between the UK and the Netherlands is rather large as the UK is a liberal market economy, where firms rely heavily on competitive markets to coordinate their endeavours, and the Netherlands is a coordinated market economy, where endeavours are generally coordinated strategically (Hall and

Thelen, 2008). From this perspective it is remarkable that the UK is amongst the chief trading partners of the Netherlands. Statistics of UK Trade & Investment (2011) and CBS Statline (2010) reveal that the UK accounts for 8.1 percent of Dutch goods exports and 10 percent of Dutch services exports (N.B. chapter three elaborates on internationalising SMEs and the economic relationship between the Netherlands and the UK). Hence while theory suggests the institutional distance between the UK and the Netherlands is rather large, and firms would face extensive liabilities of foreignness, practice shows internationalising Dutch firms are highly involved in British markets. It is therefore particularly interesting to research this apparent paradox. Here, the starting point is the assumption that Dutch firms perceive the institutional distance between the UK and the Netherlands as relatively small.

Second, the pivotal position of the UK as export-destination of Dutch firms makes a study of SME internationalisation processes to this country particularly relevant. A deeper insight in the desires and experiences of Dutch firms that internationalise to the UK could make policy intended to promote firm internationalisation towards the UK more informed, and could therefore contribute to economic growth.

## **1.2 Objective**

This thesis intends to 'provide an insight in the internationalisation processes of Dutch SMEs which operate in the United Kingdom, consequently to contribute to the further development of public policy and therefore to assist in the effective and efficient enhancement of Dutch competitiveness'. The study gives an understanding of the grounds on which SME choose certain host countries and particular entry-modes for their internationalisation. To achieve the described objective, it is necessary to review the contemporary views of internationalisation, to extend and/or adjust them, and finally to empirically research them.

## **1.3 Definitions and classifications**

There are many definitions of SMEs which vary from country to country and between the sources that report SME-related statistics (Ayyagari *et al.*, 2007). Hessels (2008) states SMEs are usually defined by their size in terms of number of employees. For example, according to the definition utilized by the EIM (2011), SMEs are companies with a maximum of 100 employees. In the United States, firms with up to 500 employees are defined as SMEs and the European Union considers firms with up to 250 employees as SMEs (Hessels, 2008). The latter definition is also used in this thesis as its most prevalent in literature (Ayyagari *et al.*, 2007).

A comprehensive part of this thesis is dedicated to the rationale behind a firm's entry-mode choice. There are various entry-modes like: indirect exports, agents, distributors, direct exports, licensing, partnerships, joint ventures and subsidiaries. This thesis follows the classification of entry-modes of Pan and Tse (2000), which is depicted on the following page.

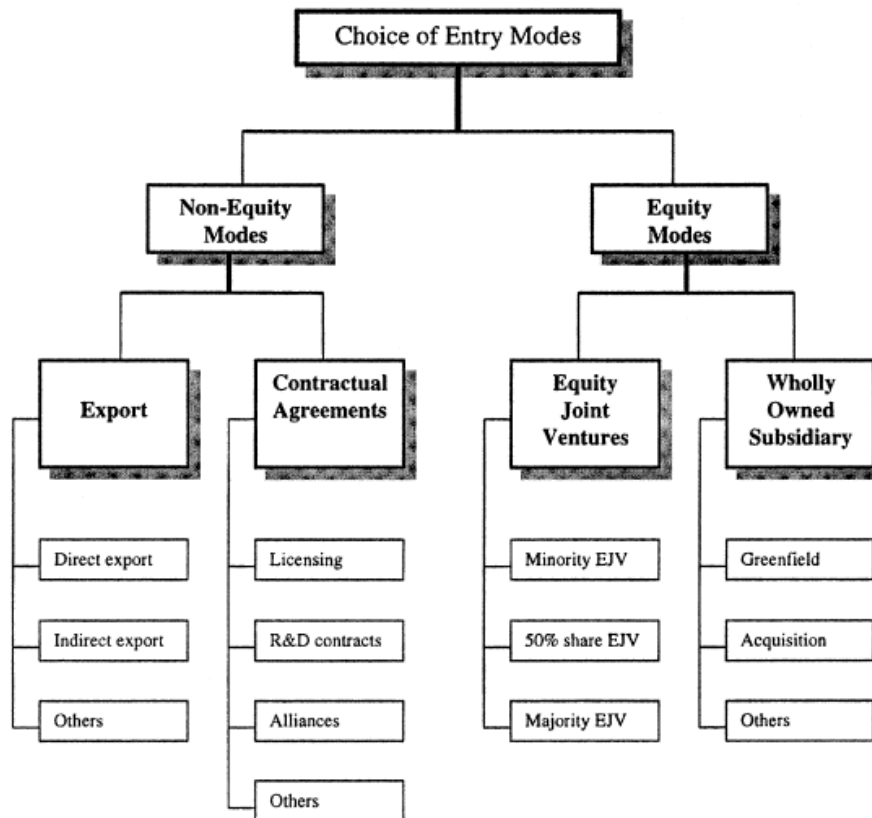


Figure 2: Classification of entry-mode choices  
Pan and Tse (2000, pp: 538)

It is important to note that the use of equity-based entry-modes requires a firm to make large commitments of (financial) resources, and gives a firm a large amount of control (Pan and Tse, 2000). Hence this study uses both the terms 'equity entry-modes' and 'high-control entry-modes' to describe joint-ventures, acquisitions and greenfield subsidiaries. On the other hand, in this study 'non-equity entry-modes' are sometimes referred to as 'low-control entry-modes' as they provide firms with less management influence on their international operations. In chapter two, firm internationalisation processes are defined as theories concerning these processes are also reviewed in that chapter.

#### 1.4 Scientific relevance

This study is focussed on internationalising small- and medium-sized firms (SMEs). SMEs are distinct from large MNEs for several reasons. For instance, SMEs have fewer resources than MNEs (Kohn, 1997). As a result, SMEs are more vulnerable to shocks, and therefore intend to minimise their exposure to risk. Moreover, a lack of capital limits the scale of foreign activities undertaken by SMEs. As a result of these particular characteristics and their distinctive behaviour, internationalising SMEs differ from large MNEs. However, literature on internationalising firms is often focussed on large companies (Fillis, 2001; Etemad, 2009). According to Acs and Preston (1997), very little is known about the processes by which small- and medium-sized enterprises participate in the global economy. Ruzzier *et al.* (2006) state only lately internationalising SMEs have attracted interest of scholars and policymakers. Even so, there is a lack of a well-developed body of knowledge on SME internationalisation processes (O’Cass and Weerawardena, 2009). This study attempts to contribute to filling this research gap.

## 1.5 Practical relevance

According to Ruzzier *et al.* (2006), nowadays SMEs are no longer considered passive victims of globalisation; rather they have become active players in the internationalised economy. In the last decades, many SMEs have successfully set up activities beyond their home markets and their role is increasingly perceived as crucial in contributing to future growth (Gjellerup, 2000). As a result, governments try to stimulate internationalisation of SMEs in order to enhance economic growth, cut unemployment, and create potential mini-MNEs in the future (Ruzzier *et al.*, 2006). Moreover, governments support cross-border entrepreneurship and in particular exports to increase national wealth and to improve the international competitiveness of the national economy (OECD, 1997). However, policy planners' desire to facilitate SME international participation is hindered by a lack of a well-developed body of knowledge on SME internationalisation (O'Cass and Weerawardena, 2009). According to Greenaway and Kneller (2007), policymakers who want to intervene in the internationalisation process of certain firms or sectors require more information to refine their policies. This thesis attempts to provide such knowledge in order to contribute to the further development of government policies.

An example of a government with an explicit intention to promote firm internationalisation is the Rutte-I administration that governed the Netherlands between October 2010 and April 2012. The policy context set by this government is formulated in its coalition statement (in Dutch: *'regeerakkoord'*). This statement noted: *"promoting trade- and economic interests of the Netherlands and Dutch firms"*, as a government objective (VVD and CDA, 2010, pp: 7). Moreover, according to the coalition statement: *"to enhance the international competitiveness of Dutch firms, the Dutch government has to intensify its international economic relations"* (VVD and CDA, 2010, pp: 8). To achieve this goal, the Rutte-administration assigned greater importance to economic diplomacy as a task of consulates, embassies and Netherlands Business Support Offices (NBSO's). Although the Rutte-I administration is no longer in office, its policies concerned with the promotion of firm internationalisation processes highlights the practical relevance of studies devoted to this topic.

## 1.6 Research questions

The main research question of this thesis is formulated as follows:

- **What drives Dutch SMEs to start operations in the UK, and what is the foundation of the internationalisation strategies with respect to entry-modes which these firms use?**

Before getting to the answer of this research question, first some subquestions are posed. These questions are:

1. What internationalisation processes are distinguished in literature, and on what grounds do firms choose the appropriate host countries and entry-modes for their internationalisation?
2. What are the drivers of Dutch SMEs to start activities in the UK?
3. Which entry-modes do Dutch SMEs operating in the UK use, and for what reasons?
4. How do Dutch firms acquire essential knowledge to engage in international activities in the UK?
5. How do Dutch SMEs that are involved in the UK differ from more extensively researched MNEs with respect to internationalisation processes?

The first subquestion is answered through a study of literature. The three following subquestions are discussed in the analysis of the empirical part of this study. Finally, the fifth subquestion relates the outcomes of the empirical part of this study to the existing literature which is predominantly focussed upon large multinational enterprises. Moreover, to acquire a more thorough understanding of the behaviour and contemplations of internationalising SMEs, an internship at NBSO Manchester is executed by the researcher. NBSO Manchester offers support to Dutch organisations that want to do business in the United Kingdom.

### **1.7 Thesis structure**

This thesis is organised as follows: the second chapter reviews theories concerned with firm internationalisation. The most dominant streams of literature with respect to this theme - resource-based theories, behavioural theories and the perspective offered by evolutionary/institutional economic geography - are discussed extensively. The learning processes in which firms engage while internationalising are also explained in this chapter. From this review of internationalisation theories an integrative conceptual framework of firm internationalisation processes is build. Chapter two concludes with the development of a number of hypotheses. The third chapter describes the context of this study and henceforth gives a description of the involvement in international markets of Dutch SMEs and the economic relationships between the UK and the Netherlands. Chapter four discusses the methods and techniques employed in the empirical part of this study. Moreover, the hypotheses are operationalised in this chapter. In the fifth chapter the empirical results of this study are analysed and discussed; the grounds on which a firm's choice for the UK as a host country is based, the reasons behind a firm's choice for a particular entry-mode, and the most pivotal characteristics of the learning processes in which firms engage while they internationalise to the UK. Consequently, this chapter is most important for answering the main research question. Finally, chapter six presents final conclusions, which include an answer to the main research question. In addition, some recommendations on Dutch policies concerned with firm internationalisation are presented as well as the theoretical and managerial implications of this study.



## 2. Theoretical framework

This goal of this chapter is to build a theoretical framework to analyse SME internationalisation processes. The first paragraph of this chapter defines internationalisation processes after which the second paragraph describes the features which make internationalising SMEs distinct from MNEs. Following resource-based (§2.3) and behavioural (§2.4) internationalisation theories are reviewed. In paragraph five the evolutionary/institutional perspective on internationalisation is discussed with particular attention for concepts concerned with institutional distance and learning processes. In the sixth paragraph a synthesis of these theories is made which results in a conceptual model of SME internationalisation processes. The final paragraph presents the hypotheses that are derived from this model and are researched in this thesis.

### 2.1 Defining firm internationalisation

As stated in chapter one, economic globalisation is ever increasing and henceforth the world economy is getting more integrated. The key actors in a globalised economy are internationalising firms (Kleinert, 2001). According to Jones (2007), the internationalisation process of these firms can be defined as:

*“A process through which firms grow and develop internationally, establish and manage their foreign operations, increase their exposure to international business through international transactions, establish and develop relationships and networks that extend across borders which is manifest and identifiable through specific entry-modes, in location in relation to time”.*

This definition emphasises cross-border transactions and foreign operations as the fundamentals of internationalisation processes. These are identifiable through three characteristics; entry-modes, locations and time. First, entry-modes comprise the operational modes through which a firm organises its international activities. For instance, a firm can operate internationally through the use of an agent, a distributor and several other operational modes. Second, the definition pays attention to the choice for a specific host location for a firm’s internationalisation. It is self-evident that firms internationalise to specific target-locations. Nonetheless, market-choices may not be as plain as they seem. Finally, time is considered a distinctive feature of firm internationalisation processes. There are firms which operate internationally shortly after start-up, while other firms wait several years before they engage in international activities. Moreover, time emphasises the evolution of a firm and its international operations. For instance, the Uppsala internationalisation process model indicates firms will switch to high-control entry-modes through time as their market knowledge increases. Therefore, next to entry-modes and host countries, time is a distinctive characteristic of internationalisation processes.

### 2.2 Internationalising SMEs versus MNEs

Most of the literature concerned with the internationalisation of firms is focussed on MNEs (Fillis, 2001; Etemad, 2009). Only recently internationalising SMEs have attracted interest, this because countries attempt to increase the international activities of their SMEs in order to boost economic growth, cut unemployment, and create potential mini-MNEs in the future (Ruzzier *et al.*, 2006). However, for a long time it is acknowledged internationalising SMEs are distinct from MNEs. Shuman and Seeger (1986) state SMEs are not smaller versions of larger companies, but mainly due to their size they tend to interact differently with their environment. The most-cited distinctive feature of

SMEs is their lack of resources (e.g. Coviello and Munro, 1997; Gilmore *et al.*, 2001; Hollenstein, 2005; Knight, 2000). In comparison to large companies, SMEs experience a deficiency of finance, have insufficient management capacity and possess limited knowledge. According to Wright *et al.* (2007), SMEs also experience a lack of skilled personnel. This is related to the absence of specialist expertise which Gilmore *et al.* (2001) observes at SMEs. For these reasons, it is difficult for SMEs to operate on foreign markets.

Limited resources also causes SMEs to lack sophisticated marketing strategies (Gilmore *et al.*, 2001). Meyer and Skak (2002, pp: 179) state: “[SME] *strategies are subject to high degrees of serendipity, i.e. fortunate and unexpected discoveries made by chance*”. For example, Westhead *et al.* (2002) found ‘micro’ firms (1 to 9 employees) to be more reactive in exporting than small firms (10 to 49 employees). Micro firms predominantly respond to trade-requests from abroad while small firms in some cases actively search for international partners/clients. Bell *et al.* (2004) researched internationalisation strategies of different types of small firms. These authors found ‘knowledge-intensive’ manufacturing firms to be more proactive with respect to internationalisation than ‘traditional’ manufacturing firms. There was some evidence of strategic thinking and planning within the first group while the second group was mainly reacting to unsolicited enquiries/orders.

The lack of resources experienced by SMEs not only limits their strategic planning abilities, it also causes the future development of these firms to be highly dependent on entrepreneurial visions and capabilities. As result, entrepreneurs have key positions in small firms and are regarded as their main decision makers (Gilmore *et al.*, 2001). This aligns with Westerberg *et al.* (1997), who state SMEs often have one single decision maker (the owner-manager), when it comes to strategic fields such as doing business abroad. This makes a SME more dependent on the business- and social networks of the entrepreneur. These networks can have a pivotal role in the internationalisation process of firms (O’Gorman and Evers, 2011). According to Curran and Blackburn (1994), owner-managers tend to have relatively small and non-expensive networks with little resort to expected external contacts such as accountants and bank managers. Yet in case of problems, entrepreneurs do make active use of these network contacts. Nonetheless, the formation and development of networks remains largely unstructured and coincidental in nature.

Finally, contrary to large companies, SMEs often lack a reputation abroad (Zyglidopoulos *et al.*, 2006). According to Larson (1992), a good reputation reduces risk and uncertainty and creates the basis for mutual trust between business partners. Reputation is therefore important in the internationalisation process of firms. For example, Agndal and Chetty (2007) empirically studied the way existing relationships influence changes in SMEs’ internationalisation strategies with respect to host markets and entry-modes. They did so by interviewing 50 representatives of 20 SMEs from Sweden and New Zealand. In their paper they state: “*reputation assets of relationships were mentioned frequently in this study, thus, highlighting the importance of such for the firm when expanding in existing markets or entering new markets*” (Agndal and Chetty, 2007, pp: 1461). Consequently, the internationalisation of SMEs can be hindered by the absence of a reputation in host countries.

### **2.3 Resource-based internationalisation theories**

The first theories aimed at analysing and conceptualising firm internationalisation processes originate from international economics and international business studies (Van Meeteren, 2011). These theories start off from a resource-based point of view, and mainly build on the work of Penrose (1959). She states the nature of a firm lies in its human and non-human resources and their

interaction (Pitelis, 2007). In her theory, a firm is described as a bundle of resources which is used to generate products or services that provide value for customers, in competition with the offerings of other firms. Firms internationalise to obtain resources and benefits like low-cost labour or access to market opportunities in foreign regions.

These two internationalisation motives have a central role in Vernon's (1966) product life cycle model. According to this theory, a product passes through five stages. These are: introduction, growth, maturity, saturation and decline. Initially, a product is usually developed in a wealthy, industrial country. In the first stages of a product life cycle, both the product and the production process are not fully developed. In these stages, firms focus on national markets and improve both the product and the production process. When the product and the production process are optimized, and maturity stage is reached, firms start exporting to foreign markets. Initially, firms will concentrate on countries similar to their home country. Meanwhile, other companies have become interested in copying the product in particular because the product now is fully developed, and no more investments in R&D have to be made. This will start competition, which will result in declining prices and profits. In this so-called saturation stage, firms will move their (production) facilities towards a foreign nation where a large market exists, and the costs of production are low. In the decline stage, demand is gradually reducing, hence sales and production are also going down. New variations and alternative products enter the market and the original, by then outdated, product is driven out of the market. At first, markets in developed countries shrink, after which markets in developing countries also diminish. Henceforth, the international product life cycle model is a theory from international business studies which assigns firm internationalisation processes to certain stages in product life cycles (Ibrahim, 2004).

Advocates of transaction costs theories point to the fact that firm internationalisation not only comes with benefits but is also accompanied by costs. This approach builds upon the work of Coase (1937). He states the functioning of the market is impaired by transaction costs associated with negotiating contracts. Williams (1997) discerns four types of transaction costs: brokerage costs, costs of defining the obligations of the contracting parties, the risk of scheduling and related input costs, and taxes paid on the transactions. As a result, firms only internationalise when the benefits of internationalisation outweigh transaction costs. Authors of internalisation theories have further sophisticated transaction cost theories. They state there are several operational modes by which a firm can gain varying levels of control over resources. A firm can fully internalise resources in foreign regions by setting up a subsidiary or making an acquisition. On the other hand, firms can (partly) externalise resources by exporting or by entering licencing-agreements (Hessels *et al.*, 2005). According to Czinkota *et al.* (2004), the key variables differentiating such entry-mode choices include varying levels of control, resource commitment, and risk.

As institutional arrangements of foreign regions differ from institutional arrangements of domestic regions, internationalising to foreign regions is accompanied with risk. In unknown, foreign environments, which are by definition risky, firms are consequently more likely to use a low-control entry-mode with a low level of resource commitment. Hymer (1976) conceptualises the lack of knowledge in the form of unfamiliarity with foreign institutional environments as a 'liability of foreignness' (this concept is explained further in §2.5).

The eclectic paradigm (OLI-paradigm<sup>1</sup>) can be conceptualised as a tool that combines the insights from resource based, institutional, and transaction cost theories (Brouthers and Hennart, 2007). John Dunning is the main founder of this paradigm which distinguishes three interrelated variables which define the extent, geography and industrial composition of foreign activities undertaken by MNEs. The ownership component describes the competitive advantages of the firm which engages in foreign direct investment (FDI). For instance, a firm can have superior management practices or possess unique technological knowledge. The greater the competitive advantages of a firm, the more likely it is to engage in, or increase its, foreign activities. The locational attractions variable is dedicated to understand the reasons why firms favour a presence in a foreign region over a domestic location. The more immobile, natural or created endowments are available in a region abroad, the more likely it is a firm engages in FDI. For instance, a region can possess abundant and high-quality production factors or have a unique market structure which could encourage a firm to internationalise towards that region. The third variable of the OLI-tripod: *“offers a framework for evaluating alternative ways in which firms may organise the creation and exploitation of their core competencies, given the locational attractions of different countries and regions”* (Dunning, 2000 pp: 164). The essence of this internalisation variable corresponds to the previously reviewed internalisation and transaction costs theories. Hence this variable is dedicated to understand the way by which firms internalise the attractions of the foreign region they invest in.

The resource-based theories reviewed above give insights in the reasons behind a firm’s internationalisation. They emphasise the potential economic benefits of internationalisation rather than the process leading up to it (Van Meeteren, 2011). Consequently, Hessels *et al.* (2005) classify these theories as static internationalisation theories. Yet there are theories which pay attention to process-elements of internationalisation. These theories start of from a behavioural perspective and are reviewed in the following paragraph.

## **2.4 Behavioural theories of firm internationalisation**

The first process theory about firm internationalisation to surface in literature is the Uppsala internationalisation process model. This internationalisation process model was first published in 1977 by Johanson and Vahlne. From a behavioural point of view, it considers the internationalisation process of a firm as an evolutionary process in which the enterprise gradually increases its international involvement as it obtains more information about international markets. Accordingly, experimental learning and commitment building have an important role in this process.

The Uppsala model is described as follows; At first a distinction is made between state and change aspects of internationalisation. State aspects are market commitment and market knowledge, and the change aspects are current business activities and commitment decisions. Market knowledge and market commitment are assumed to affect decisions regarding commitment of resources to foreign markets and the way current activities are performed. Market knowledge and market commitment are in turn affected by commitment decisions and current activities. Thus, the process is seen as a continuing causal cycle (figure 3).

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<sup>1</sup> OLI-paradigm: Ownership, Location and Internalisation

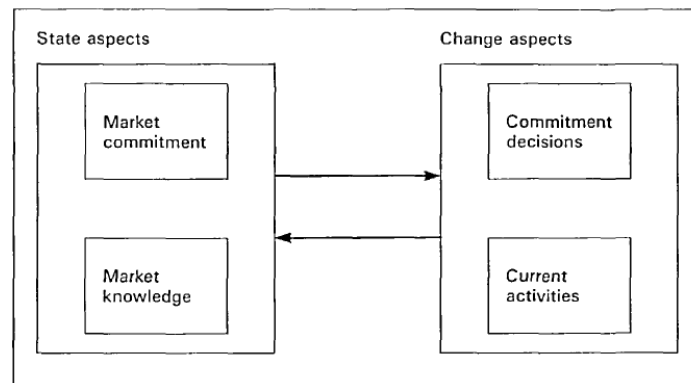


Figure 3: The internationalisation process of the firm  
Johanson and Vahlne (1990)

The internationalisation process model follows Penrose (1959) by distinguishing two types of knowledge (Johanson and Vahlne, 1990). The first is objective knowledge which by definition can be taught. The second is experiential knowledge which can only be acquired through personal experience. The Uppsala model assumes market knowledge is primarily acquired through experience that results from current business activities. As a result, experiential market knowledge uncovers business opportunities and reduces market uncertainty. Therefore, according to the Uppsala internationalisation model, a firm is expected to make stronger commitments to a country as its market knowledge increases.

The Uppsala model has two important implications: First the model suggests firms will initially internationalise to physically near markets as information flows are less exposed to barriers in these cases.<sup>2</sup> These physically near markets are often also geographically proximate to firms' home countries (Garbe and Richter, 2009). Second, the Uppsala model predicts internationalising firms to start off with low-control entry modes (non-equity entry-modes like agents or distributors) and as their market knowledge increases, firms will adjust to operational modes which assure higher levels of market commitment, and therefore higher levels of control (equity entry-modes like joint-ventures or wholly-owned subsidiaries).

The Uppsala model has proven to be one of the most dominant internationalisation process models. However, the model has also attracted much criticism. Andersen (1993) provides three critical remarks concerned with the Uppsala model. First, firms with ample resources are able to take larger internationalisation steps because they experience limited consequences of their commitment decisions. Second, if markets conditions are stable and homogeneous, relevant market knowledge can be acquired through other ways than experience. Third, if a firm has sufficient international experience about particular foreign markets, it may be able to generalise this experience to markets with similar characteristics. In these cases incremental build-ups of commitment are unnecessary.

Additionally, while the stage approach of the Uppsala model emphasises gradual internationalisation, since the 1990s and 2000s rapid internationalising firms have appeared on the economic stage: so-called born globals or international new ventures. Born globals are firms that begin operating in several foreign markets from start-up or soon thereafter (Melén, 2009). Knight

<sup>2</sup> Johanson and Vahlne (1977, pp: 24) define physic distance as: "the sum of factors preventing the flow of information from and to the market. Examples are differences in language, education business practices, culture and industrial development".

and Cavusgil (2004) indicate that even though born globals have scarce financial resources, they often internationalise within three years after their establishment. As so, born global firms are defined as: "*business organizations that from inception, seek to derive significant competitive advantages from the use of resources and the sale of outputs in multiple countries*" (Oviatt & McDougall, 2005, p. 31). Therefore, the defining characteristic of a born global is its accelerated internationalization (Weerawardena *et al.*, 2007). Moreover, literature about born globals also indicates these firms do not internationalise to geographically near countries and do not incrementally increase their market commitments. Hence in contrast to the Uppsala model, born globals internationalise to various countries regardless of geographical and cultural distance, and they do so through various operational modes. Empirical studies have shown that especially knowledge-based and knowledge-intensive industries are able to make such fast internationalisations (Kalinic and Forza, 2011).

Madsen and Servais (1997) attribute the rise of born globals to three interrelated reasons. First, changing market conditions like increased specialisation have opened up several niches. As a result, the number of firms producing specific parts and components, which they have to sell on international markets since domestic demand is too small, has increased. Second, technological developments in the areas of production, transportation and communication, have made small-scale operations economically sound. In addition, these developments have resulted in declining transportation costs which have diminished cost barriers to an international approach. As a result, international markets have become more accessible, especially for SMEs. Finally, the increased ability of human resources to exploit the possibilities of technological changes on international markets has contributed to the rise of born globals. This is primarily due to the fact that a dramatically increasing number of people has gained international experience during the last couple of decades. This development can be illustrated by the fact that between 1987 and 2010, roughly 2.3 million European students have studied abroad under the umbrella of the Erasmus programme (European Commission, 2012).

Next to the Uppsala internationalisation model and literature about born globals there is another influential process perspective on firm internationalisation: network theory. Networks are defined as sets of two or more connected exchange relationships (Axelsson and Easton, 1992). These relationships occur between actors who are tied to each other through a number of different bonds; for instance, technical, administrative, social, cognitive, legal, and economical. With respect to networks and internationalisation, O’Gorman and Evers (2011) state networks can have an information mediating role in internationalisation. Networks can identify foreign market opportunities and customers, facilitate introductions to international customers and provide foreign market knowledge. In addition, resources can come available to firms through networks.

Johanson and Vahlne (1990) have reacted to the rising attention for the network-concept, and they have adapted their original Uppsala model to incorporate networks. They state: "*An extension of the internationalisation process model to take into account the network aspect should consequently make the concepts "commitment, knowledge, current activities and commitment decisions" as multilateral rather than unilateral as in the original model*" (Johanson and Vahlne, 1990, pp: 19). This results in the following graphic representation:

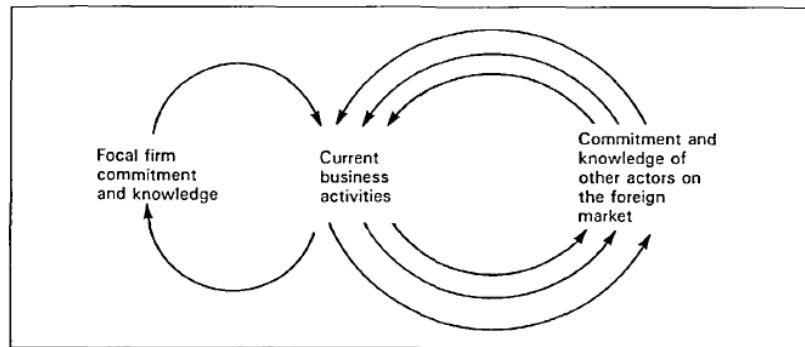


Figure 4: The multilateral aspect of the internationalisation process  
Johanson and Vahlne (1990)

In this internationalisation process model, the network perspective indicates an internationalising firm is originally active in a predominantly domestic network. When a firm internationalises, it develops network relationships with actors in other countries. According to Van Meeteren (2011), this shift has reduced attention for knowledge conveyed through networks towards the structure of networks. He states the model van Johanson and Vahlne now suggests a 'liability of outsider-ship' instead of a 'liability of foreignness'.

Eden and Miller's (2004) conceptualisation of the 'costs of doing business abroad' (CDBA) suggests the 'liability of foreignness' and the 'liability of outsider-ship' are related. The first step in their conceptualisation is they split up CDBA into 'economic market-based activity costs' and the 'liability of foreignness'. The first type of costs is predominantly economic and mainly related to geographical distance. These costs include transportation and communications costs, the costs of overcoming trade barriers and costs associated with foreign exchange transactions. Second, they decompose the 'liability of foreignness' into three main hazards which affect foreign firms disproportionately to local firms in the host country.

First, these authors discern unfamiliarity hazards which "*reflect the lack of knowledge of or experience in the host country, which places the foreign firm at a disadvantage compared to local firms*" (Eden and Miller, 2004, pp: 10). These hazards are related to the longevity of a firm's presence in a host country. A short presence in a host country means a firm does not have the same level of market knowledge as domestic firms. This causes additional costs for foreign firms. Second, discrimination hazards place foreign firms behind domestic firms when doing business. Discrimination hazards can arise by differential treatment by governments, firms, the general public and consumers. Consequently, Eden and Miller (2004) state discrimination hazards focus on the challenges of obtaining external legitimacy. Third, these authors point to relational hazards which are related to the costs of organisation all firms face. These costs can take the form of internal organization costs (intrafirm transactions) and external organization costs (external market transactions). Both types of costs are higher for foreign firms than for domestic firms. Eden and Miller (2004) cite Anderson and Gatignon (1986) by arguing that MNEs face greater uncertainty than domestic firms, both in terms of external uncertainty (due to the unpredictability of foreign environments) and internal uncertainty (due to the difficulties of managing employees at a distance and from different cultures). Internal uncertainties arise from the inability of a firm to predict the behaviour of individuals in a foreign region. Individuals could engage in opportunistic behaviour like cheating, distortion of behaviour and shrinking responsibility (Williamson, 1985). A firm can set up a form of internal control to minimise this sort of behaviour. However, controlling foreign operations

is a special skill that requires time to develop and refine (Anderson and Gatignon, 1986). External uncertainties arise by operating in an unknown foreign (business) environment. For instance, there might be uncertainty about the ability to enforce contracts and political stability. Relational hazards and discrimination hazards represent the 'liability of outsidership' as defined by Van Meeteren (2011). To sum up, foreign firms experience unfamiliarity, discrimination and relational hazards which affect foreign firms disproportionately compared to local firms in the host country. The combination of these hazards constitutes the liabilities of foreignness which firms face when they start activities abroad.

## 2.5 Evolutionary/institutional economic geography

### 2.5.1 Routines

Evolutionary economic geography builds on the (behavioural) notion that firms face uncertainty in their operations because of incomplete information, complexity and continuous change. As a result, firms do not act fully rational and behave more like 'satisfiers' than 'optimisers' (Simon, 1972). For this reason, firms develop organisational routines (Boschma and Frenken, 2006a). Routines refer to the standard operating behaviour of firms and their adaptation of internal strategies to the environment. In the words of Hagedoorn and Narula (1995, pp: 2), routinised behaviour implies that: *"firms are usually better equipped to do more of the same, in particular in different or changing market environments, than to fundamentally change their strategies on one or more of their operating characteristics"*. Consequently, when firms face challenges and decisions in international markets, they generally apply solutions that have been successful in the past (Sharma and Blomstermo, 2003).

Organizational routines, as for individual skills, consist of a large part of experience knowledge (learning-by-doing) and tacit knowledge. In this regard, Dosi and Nelson (1994) state routines are shaped by the learning history of agents and their pre-existing knowledge. Consequently, organisations are therefore not only persistently heterogeneous in their routines, their behaviour is also path dependent (Boschma and Frenken, 2006b). In evolutionary economic geography, this variety generates selection processes, causing some firms to prosper and grow while others decline and possibly exit. Hence opposite to neoclassical theories' fixation on equilibriums, evolutionary economic geography regards economies to be inherently dynamic (Nelson and Winter, 2002).

### 2.5.2 Institutional distance

Although firms are heterogeneous in their routines, a degree of similarity is also manifested in the routines of firms in certain units as institutions constrain economic behaviour (Boschma and Frenken, 2006a). Institutions are defined by Scott (1995, pp: 33) as: *"cognitive, normative, and regulative structures and activities that provide stability and meaning to social behaviour"*. Routines should not conflict with territorial institutions, and as institutional variation mainly appears on a national level, internationalising firms face challenges when they enter foreign markets (Boschma and Frenken, 2006a).

The varieties of capitalism literature (VOC) is dedicated to the study of geographical differentiated patterns of (mostly formal) institutions. *"The varieties of capitalism approach to the study of capitalism rests on the argument that different national economic institutions—which can include such things as the financial system, the vocational training system and the industrial relations system—offer different opportunities to companies; as companies are likely to be aware of these*



*opportunities, firms will, on the whole, adjust their production strategies as well as their use of different types of human capital (either general or firm specific) to take advantage of these opportunities*" (Allen, 2004, pp: 91). This stream of literature emphasises the distinction between liberal market economies, where firms rely heavily on competitive markets to coordinate their endeavours, and coordinated market economies, where more endeavours are coordinated strategically (Hall and Thelen, 2008). The dualism in the identification of these two models parallels the debate between political philosophies - neoliberalism and social democracy – which lies behind many VOC analyses (Crouch, 2005).

The VOC-literature indicates that countries operate different institutional systems. In this light, and following the Scott's (1995) definition of institutions, Kostova (1996) developed a concept concerned with institutional distance. Institutional distance between two countries is defined as: *"the degree of difference/similarity between the regulatory, cognitive, and normative institutions of two countries"* (Eden and Miller, 2004, pp: 17). Eden and Miller (2004) state institutional distance can be different for each institutional pillar. The regulatory pillar of an institutional environment reflects the existing laws and rules in a certain national environment that promotes particular types of behaviours and restricts others (Kostova, 1999). The regulatory pillar in host countries is perhaps the most transparent pillar - and therefore most easy for foreign firms to observe, understand and correctly interpret - because regulatory institutions are codified and formalized in rules and procedures (Eden and Millar, 2004). The cognitive institutional pillar reflects the cognitive categories which the people in a particular country generally share. *"Cognitive programs such as schemas, frames, inferential sets, and representations affect the way people notice, categorize, and interpret stimuli from the environment"* (Kostova, 1999, pp: 314). The normative pillar of an institutional environment is dedicated to the values and norms held by the individuals in a given country. These normative prescriptions and proscriptions are often culturally driven, which makes them predominantly tacit and therefore difficult to understand and internalise by outsiders.

The distinction between the institutional pillars can be quite 'theoretical and vague'. Hence Eden and Millar (2004, pp: 16) also describe the differences between the institutional pillars more straightforward: *"while the regulatory pillar defines what organizations and individuals 'may or may not do' (where 'may' implies permission), the normative pillar defines what they 'should or should not do'. The cognitive pillar defines what 'is or is not true' and what "can or cannot be done' (where 'can' implies ability). Thus, the three institutional pillars are akin to three verb tenses: may/may not (regulatory), should/should not (normative) and can/cannot (cognitive)."*

Hence the larger the institutional distance between a firm's domestic country and its host country, the more a firm has to deal with a 'liability of foreignness', and the more it has to sophisticate its routines. However in order to do so, firms have to engage in learning processes.

### **2.5.3 Learning processes**

Firms can be seen as a collection of productive resources and capabilities which compete on the basis of their routines and core competences that are built up over time (Mutinelli and Piscitello, 1998; Nelson and Winter, 1982). Routines can be considered as the organisational counterpart of what is called skill at the level of the individual (Van den Belt and Rip, 1989; Nelson and Winter, 2002). As for individual skills, organisational routines consist for a large part of experience knowledge (learning-by-doing) and tacit knowledge (Boschma and Frenken, 2006a). Accordingly, the routines (core competencies) which enable a firm to compete successfully in the market arena are built through learning processes (Mutinelli and Piscitello, 1998). This is confirmed by Dosi and Nelson

(1994), who state routines are shaped by the learning history of agents and their pre-existing knowledge. Routines can therefore be understood to entail both more stable and more dynamic elements. In this regard, Zollo and Winter (2002) distinguish two types of firm activities: operational routines and dynamic capabilities. Operational routines are geared towards the operational functioning of the firm. Dynamic capabilities are dedicated to the modification of operating routines. They can be defined as: *“a learned and stable pattern of collective activity through which the organization systematically generates and modifies its operating routines in pursuit of improved effectiveness”* (Zollo and Winter, 2002. pp: 340). For that reason, dynamic capabilities represent learning processes.

Hagedoorn and Narula (1995, pp: 4) discern two types of learning: *“routinised learning that involves gradual changes, which governs the majority of learning experiences of companies, and the much more unusual process of learning that implies radical changes in company routines”*. Routinised learning (exploitative learning) adds to existing knowledge and competencies of a firm without fundamentally changing the nature of its activities. On the other hand, non-routinized learning (exploratory learning) involves changes in company routines and experimentation with new alternatives. The satisficing strategy of firms implies that in order to survive, firms have to find a balance between exploitative and explorative learning. Yet firms follow their routines when they adapt their internal strategies to their environment (Hagedoorn and Narula, 1995). Consequently, firm learning processes often have a repetitive nature; i.e., they are directly related to a firm’s organizational routines what turns their learning experience into cumulative learning, building upon what was learned before. In most cases this restricts the degree of experimentation (exploratory learning) in which firms are involved, because the main part of a firm's search for new opportunities and company experimentation is assumed to be local in scope. Consequently, changes in the behaviour of firms, for instance with respect to their internationalisation strategies, are guided by heuristics that reduce the number of alternatives through a quasi stable commitment to a particular set of alternatives, for instance with respect to host country selection.

Malerba (1997) discerns six principal methods through which firms learn, and specifies whether they are internal or external to firms:

- Learning by doing, internal to the firm;
- Learning by using, internal to the firm;
- Learning by searching (R&D), internal to the firm;
- Learning from advances in science and technology, external to the firm;
- Learning by inter-industry spillovers, external to the firm;
- Learning by interacting, external to the firm.

These types of learning processes may be closely interrelated. Malerba (1997) states for instance that learning by searching may take place along with learning from advances in science and technology, learning by doing and learning by interacting. With respect to internationalisation and reducing a firm’s ‘liability of foreignness’, ‘learning by using’ is irrelevant since this type of learning is related to *“the use of products machinery and inputs”* (Malerba, 1997, pp: 848). The same holds for ‘learning from advances in science and technology’ and ‘learning by searching (R&D)’. Therefore, ‘learning by doing’, ‘learning by interacting’ and ‘learning by inter-industry spillovers’ are most relevant with respect to firm internationalisation.

However, the distinction between the last two processes is not straightforward. It is possible for firms to obtain knowledge by interacting with firms in similar industries. In addition, spillovers

can be conceived as a consequence of interaction. Therefore, Van Meeteren (2011) distinguishes internal and external learning processes in which the latter is split up in horizontal interactions, vertical interactions and interactions with NGO's and government organisations, as means of obtaining knowledge in a learning process. Here, horizontal interactions are concerned with knowledge shared between firms that do not interact within the same value chain and are usually competitors or active in different niches. Vertical interactions represent linkages with firms within the same value chain (e.g. clients, suppliers and business service firms). The conceptual breakdown into external learning processes ('learning by interacting') and internal learning processes in terms of 'learning by doing' is also used in this thesis.

With respect to external learning processes ('learning by interacting'), the geographical scales of interactions are of importance when analysing learning processes (Gertler, 2001). Learning processes are multiscale, but some properties of knowledge transfer differ amongst scales (Van Meeteren, 2011). In other words, differences in transferability of certain types of knowledge are essential in explaining geographies of learning processes. The conceptual distinction between codified knowledge and tacit knowledge is fundamental here. Codified knowledge consists of 'structured data and the necessary instruction for its processing' and 'knowledge reduced to symbolic representations' (Johnson *et al.*, 2002). Consequently it is relatively easy to transfer this type of knowledge. On the other hand, tacit knowledge is "*difficult to articulate or codify because it 'articulated' through practical skills and cannot be reduced to numbers, graphs, maps, diagrams, texts, formulas, etc*" (Asheim and Coenen, 2007, pp: 655). As a result, it is more complicated to store and transmit this type of knowledge through information and communication technologies. However, face-to-face contact makes it easier to transfer tacit knowledge and to decode codified knowledge since it permits a depth and speed of feedback that is impossible in other forms of communication (Storper and Venables, 2004). Moreover, face-to-face contact promotes trust in relationships and facilitates screening and socialising which results in actors losing their anonymity. Consequently, learning through interactions is easier in spatial proximity.

Nevertheless, Boschma (2005) has some critical remarks concerning localised learning. He states geographical proximity is neither a necessary nor a sufficient condition for learning to take place. Other forms of proximity, like relational, social, organisational and institutional proximity, are also important in learning processes. Boschma (2005) states the role of geographical proximity in learning processes is mainly facilitative. In addition, learning processes are not exclusively a localised phenomenon. Firms also tap into external pools of knowledge by establishing relations with distant firms. Bathelt *et al.* (2004) define these relations as 'global pipelines'. Participation herein is not free and requires specific investments. Partners must be selected, and partners on both ends of the pipeline must develop a joint interpretative context in order to engage in interaction. Hence firms must have an understanding of the institutional context in order to communicate successfully and be able to learn. A firm's ability to learn is therefore related to its 'absorptive capacity'. Cohen and Levinthal (1990, pp: 128) use the term 'absorptive capacity' when they refer to a firm's ability to "*recognise the value of new, external information, assimilate it, and apply it to commercial ends*". Chetty and Campbell-Hunt (2003) suggest that a firm's capacity to absorb knowledge is dependent on its existing knowledge (routines).

#### **2.5.4 Internationalisation: a permanent learning process**

The integration of the aforementioned theories leads to the conception that firms, based on their existing routines, satisfy their corporate objectives by internationalising to those countries that not

necessarily have the highest theoretically possible returns, but which demonstrate a certain institutional similarity that enables them to follow as much of their existing routines as possible (Hagedoorn and Narula, 1995). From the start of a firm's operations in a foreign country, it engages in a process of learning, involving an incremental acquisition of knowledge (Araujo and Rezende, 2003). The new knowledge based on a firm's foreign experiences is then absorbed, shared and built up over time by means of certain organizational routines (Casillas *et al.*, 2009). Firms have to obtain market knowledge and learn about norms of stakeholders and local (business) culture in order to reduce the institutional distance of foreign countries and consequently limit their exposure to uncertainty hazards, discrimination hazards and relational hazards. In these learning processes, firms have to deal with transaction costs related to the possible need for interactions with partners and potential opportunistic behaviour on their behalf, and difficulties with the management of relationships with these partners. Firms also have to deal with broadly meant information costs concerning the need for the acquisition knowledge and competencies about markets and partners (Mutinelli and Piscitello, 1998). The longer a firm operates abroad, the more it learns and builds up foreign experience, the smaller the 'liability of foreignness' it faces. A limited 'liability of foreignness' ensures firms can use entry-modes which give higher levels of control because they are exposed to lower levels of risk and experience less uncertainty (Blomstermo *et al.*, 2006).

## 2.6 Conceptual model

Jones (2007) defines internationalisation processes of firms as: *"A process through which firms grow and develop internationally, establish and manage their foreign operations, increase their exposure to international business through international transactions, establish and develop relationships and networks that extend across borders which is manifest and identifiable through specific entry modes, in location in relation to time"*. Consequently, the observable outcomes of internationalisation processes are target locations and entry-modes. The literature review has made clear that these outcomes have a dynamic nature and change over time. Consequently, the internationalisation of firms can be seen as an evolutionary process.

The review of internationalisation theories above gave insights in the role of (institutional) knowledge of foreign regions as a firm resource. Knowledge about foreign regions is entailed in firm routines through internal and external learning processes. This results in a reduction of the institutional distance of foreign regions. Here institutional distance is understood as: *the degree of difference/similarity between the regulatory, cognitive, and normative institutions of two countries"* (Eden and Miller, 2004, pp: 17). The extent to which institutional distance is reduced, and knowledge about the host country's market, norms of stakeholders and local (business) culture is incorporated in a firm's routines, influences the 'liability of foreignness' a firm experiences. These liabilities manifest themselves through unfamiliarity hazards, discrimination hazards and relational hazards. By using this conceptualisation, this study partly aligns with the following conceptualisation of Eden and Miller (2004).

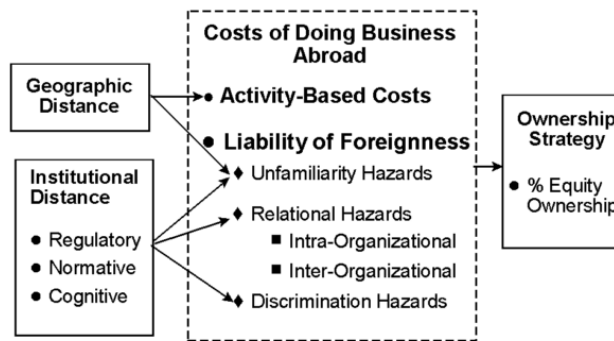


Figure 5: Institutional distance, the costs of doing business abroad and ownership strategy  
Eden and Miller (2004, pp: 37)

Nonetheless there are three important differences between Eden and Miller’s (1994) conceptual model and the conceptual model used in this study. First, this study does not pay attention to geographical distance since it focuses on ‘liabilities of foreignness’ and learning processes. In addition to this argument, the rise of born globals indicates that the importance of geographical distance is declining. The second difference between Eden and Miller’s (1994) conceptualisation and the conceptual model used in this thesis, is the inclusion of learning processes which influence a firm’s routines in this thesis. These learning processes consist of internal learning processes (‘learning by doing’) and external learning processes (‘learning by interacting’). The importance of interactions is acknowledged by Jones (2007) in his definition of internationalisation processes which states internationalising firms “*establish and develop relationships and networks that extend across borders*”. Firms can also learn through internationalising. For instance, they can get accustomed to foreign norms and learn about the characteristics of certain markets. Third, unlike Eden and Miller (2004), this study not only pays attention to ownership strategy (i.e. entry-mode), but also to host country selection processes and the evolution of both. This is in accordance with Jones’ (2007) definition of internationalisation processes, which suggests internationalisation is “*manifest and identifiable through specific entry modes, in location in relation to time*”.

Internationalisation processes of SMEs are supposed to differ from the international development of MNEs. The grounds of this assumption are the facts that SMEs have limited resources, lack strategic planning capabilities, assign a key role to the entrepreneur, have limited networks and lack a reputation abroad. Consequently, SMEs are supposed to be less able to engage in learning processes and have restricted capabilities reflected in their routines.

These considerations combined with the relationships and processes discussed in the previous paragraphs lead to a synthesis which is demonstrated in the following conceptual model:

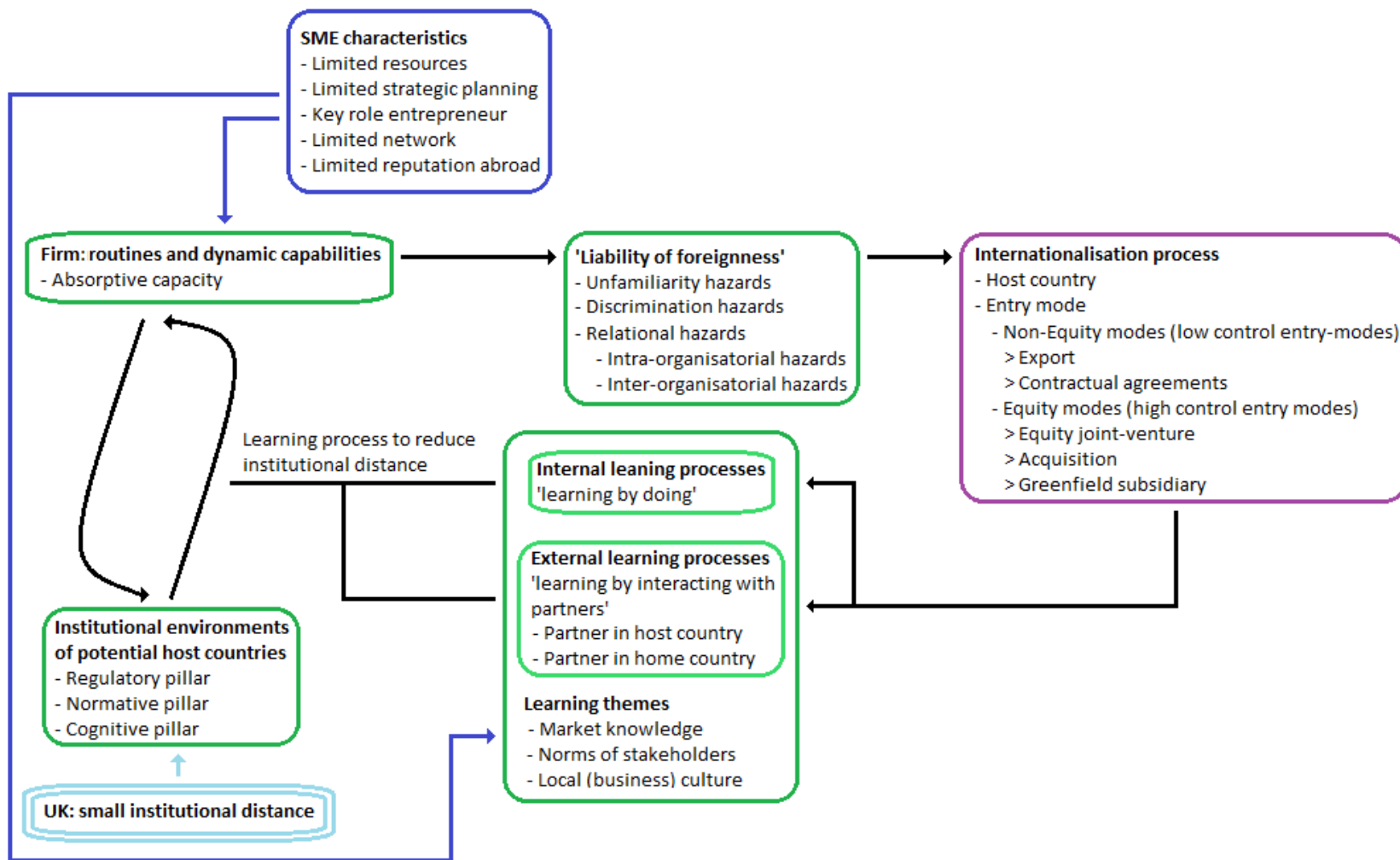


Figure 6: Conceptual model

## 2.7 Hypotheses

The theoretical framework and resulting conceptual model that are described in the preceding paragraphs are the foundations on which several hypotheses are built in this paragraph. These hypotheses are tested in the empirical part of this thesis. Not every element of the conceptual model is incorporated in a hypothesis. Only the elements that are related to the research questions are hypothesised.

SMEs face several limitations with respect to resources, strategic planning, network involvement and reputations abroad. As a result, SMEs are not able to engage in far-reaching learning processes, and subsequently these firms experience relatively extensive 'liabilities of foreignness'. This has two consequences: First, SME will predominantly internationalise to host countries which they perceive as institutionally close. By doing so, SMEs do not experience extensive liabilities of foreignness and avoid extensive learning processes which are accompanied by high transaction costs. Hence the researched SMEs are expected to internationalise to the UK as it is institutionally close.

- **Hypothesis 1:** Dutch SMEs internationalise to the UK since it is an institutionally close host country where these SMEs face limited liabilities of foreignness.

Second, in institutionally close host countries, SMEs do not have to engage in far-reaching learning processes to refine their routines. Consequently, internationalising to institutionally close countries enables SMEs to use high-control entry modes to pursue strategies with high profit potential without being exposed to high levels of uncertainty and risk (Pan and Tse, 2000). The researched SMEs are therefore expected to be able to use equity entry-modes to enter the British market.

- **Hypothesis 2:** Dutch SMEs that internationalise to the UK are able to use equity modes to enter the British market as the UK is institutionally close to the Netherlands, which causes these SMEs to face limited liabilities of foreignness in this country.

The preceding theoretical framework and conceptualisation of firm internationalisation made clear SMEs can reduce the 'institutional distance' of foreign regions through learning processes. Learning processes ensure knowledge about foreign regions is incorporated in firm routines. With respect to firm internationalisation processes, obtaining market knowledge and knowledge about both norms of stakeholders and local (business) culture is of key importance. Since these features have a dynamic character, for example, consumer tastes are highly volatile (Jansen and Piermartini, 2009), internationalising firms have to engage in permanent learning processes to successfully develop their international activities. The more knowledge is incorporated in firm routines, the smaller a firm's 'liability of foreignness'. The two predominant types of learning are internal learning processes ('learning by doing') and external learning processes ('learning by interacting with partners').

- **Hypothesis 3:** Dutch SMEs that internationalise to the UK engage in internal learning processes ('learning by doing') and external learning processes ('learning by interacting with partners') to obtain market knowledge and knowledge about both norms of stakeholders and local (business) culture.

### 3. Context: Internationalising Dutch SMEs and Anglo-Dutch economic relations

The Dutch economy is among the most internationalised in the world (Jaarsma, 2005). The Dutch Ministry of Economic Affairs, Agriculture and Innovation (2012) provides several statistics to illustrate this state of affairs. For example, about a third of the national income of the Netherlands (excluding the public sector) originates from foreign activities of Dutch firms. Moreover, the volume of Dutch imports is seventh largest of the world and the volume of Dutch exports is fifth largest in the world. With respect to FDI, the total stock of outward FDI coming from the Netherlands is seventh largest in the world and the total stock of inward FDI entering the Netherlands is eighth largest in the world. Another indicator of the internationalised character of the Dutch economy is provided for by Groot and Möhlmann (2005). These authors point out that the ratio between total exports and GDP in the Netherlands exceeds 70 percent while in other OECD-countries this ratio is on average 25 percent. With respect to gross value added (GVA), they find that 66 percent of GVA of the Dutch manufacturing sector and 24 percent GVA from the Dutch service sector to originate from exports.

It is therefore apparent the Dutch economy is highly internationalised. As this thesis is focused on Dutch SMEs which are involved in business activities in the UK, the following paragraph describes the involvement in international markets of Dutch SMEs. The second paragraph maps out the economic relationship between the UK and the Netherlands. The final paragraph of this chapter gives a general characterisation of Dutch SMEs which operate on the British market and the difficulties which accompany such a description.

#### 3.1 Internationalising SMEs in the Netherlands

SMEs constitute an important part of the Dutch economy. According to the EIM (2011), in 2010 there were 775,100 SMEs in the Netherlands which employed 3,560,000 persons and had a turnover of €386 billion. Dutch SMEs are intensively involved in international markets. To illustrate, in 2007 SMEs were responsible for roughly 53 percent of total Dutch exports and in 2010 about 21 percent of the turnover of Dutch SMEs came from international activities. Roughly one out of three Dutch SMEs engages in international activities. These firms mostly import (27 percent of Dutch SMEs), yet a large number of SMEs is also involved in exports to foreign markets (19 percent of Dutch SMEs), and a limited number of SMEs has one or more subsidiaries abroad (4 percent of Dutch SMEs). When the percentage of SMEs involved in exports is put in an international perspective, the involvement in international markets of Dutch SMEs turns out to be average in comparison with their European counterparts (Hessels *et al.*, 2005). For example, SMEs from Denmark, Austria, Switzerland and Sweden are more internationally involved while SMEs from France, Portugal, Iceland and Greece operate to a lesser extent on international markets.

Statistics of the EIM reveal internationalising Dutch SMEs are mostly active in the industrial sectors wholesale, manufacturing, transport & communication and retail. With respect to firm size, statistics of the EIM show medium-sized firms (10-100 employees) are more internationally involved than small-sized firms (up to 10 employees). This could be explained by the lack of resources experienced by small firms (Westhead, 1995; Calof, 1994). In general large firms have more resources than small firms which allows them to overcome resource-related constraints on foreign operations more easily.

The EIM has data available about the internationalisation intensity of Dutch SMEs in 2007. This data concerns direct sales of Dutch firms to foreign clients as a percentage of total turnover.



This data can be further subdivided into small- and medium-sized firms and into various industrial sectors. With respect to the agricultural sector, the positive relationship between firm size and internationalisation intensity is demonstrated by the fact that eight percent of the total turnover of small-sized firms in the ‘agriculture, forestry and fishery sector’ comes from international activities while medium-sized firms in this sector obtain 21 percent of their turnover from international activities. The same holds true for mining activities; small-sized firms obtain twelve percent of their turnover from international activities and medium-sized firms 26 percent.

The following table demonstrates the positive relationship between firm size and internationalisation intensity for the secondary sector (manufacturing). Organised by subsector, the percentage of total firm turnover which originates from international activities is shown for both small-sized firms (2-9 employees) and medium-sized firms (10-99 employees).

<b>Manufacturing</b>	<b>Small-sized firms</b>	<b>Medium-sized firms</b>
Food- and beverage industry	11%	27%
Textile, clothing and leather industry	22%	43%
Timber- and building materials industry	7%	11%
Paper and cardboard industry	23%	32%
Publishing, printing and reproduction of recorded media	4%	5%
Chemical industry	29%	47%
Rubber- and plastics industry	25%	26%
Basic metals industry	9%	45%
Metal products industry	14%	20%
Machinery industry	7%	44%
Electronics industry	28%	37%
Transport equipment industry	24%	26%
Furniture industry	6%	13%
Industry total	14%	31%

**Table 1: Internationalisation intensity SMEs in manufacturing  
EIM (2007)**

The table above shows the internationalisation intensity of small-sized firms is lower than the internationalisation intensity of medium-sized firms in all manufacturing sectors. More important, the international character of several sectors is also highlighted in table 3. Especially the ‘textile, clothing and leather industry’, the chemical industry, basic metals industry, machinery industry and the electronics industry are highly involved in international markets. With respect to the ‘basic metals industry’ and machinery industry, the difference in the international involvement between small- and medium-sized firms is noteworthy. This finding could point out to the existence of a resource-threshold in these sectors; a firm can only internationalise when it has a certain amount of resources (e.g. financial, managerial, network-related).

The following table depicts the internationalisation intensity of Dutch SMEs active in the service sector.

Services	Small-sized firms	Medium-sized firms
Construction sector	1%	1%
Automobile sector	3%	6%
Wholesale	23%	29%
Retail	1%	1%
Catering sector	0%	0%
Transportation sector	9%	14%
Communication sector	3%	1%
Real estate	0%	0%
Business services	3%	8%
Other services	2%	2%

Table 2: Internationalisation intensity SMEs in services  
EIM (2007)

It is striking nearly all service sectors are to a lesser extent involved in international markets than their counterparts in the manufacturing sector. Solely wholesale is a service sector which is highly internationalised. Besides it is notable that small-sized firms in the communication sector are more internationally involved than medium-sized firms in this industry.

### 3.2 Economic relationship between the UK and the Netherlands

With respect to the economic relationship between the Netherlands and the UK it is evident both countries are deeply interconnected. According to statistics of UK Trade & Investment (2011), the Netherlands was the destination for 6.4% of British exports in 2010, totalling nearly €24 billion. Data about Dutch imports from the UK are also available at the Dutch national statistics agency: the CBS. These statistics make clear goods imports from the UK account for 7% of total Dutch goods imports which makes the UK the fifth largest import partner of The Netherlands (CBS, 2011). Dutch imports from the UK consist mainly of mineral fuels, chemical products, and machines.

In 2010, Dutch exports of goods to the UK totalled around €30 billion, 8.1% of total Dutch exports (UK T&I, 2011). According to CBS Statline, in 2011 this quantity rose to €32 billion. As a result, after Germany, Belgium and France, the UK is the fourth biggest export destination of Dutch firms. The following table shows especially machines, chemical products and 'food and live animals' are exported to the UK.

Category	Exports value (thousand Euros)
Food and live animals (e.g. meat, cereals and tea)	4,857,588 (15,0%)
Beverages and tobacco	524,987 (1,6%)
Crude materials, inedible except fuels (e.g. textile fibres)	1,384,535 (4,3%)
Mineral fuels, lubricants and related materials (e.g. petroleum)	4,438,823 (13,7%)
Animal & vegetable oils, fats & waxes	419,312 (1,3%)
Chemicals & related products, n.e.s. (e.g. fertilizers and plastics)	5,701,513 (17,6%)
Manufactured goods (e.g. leather, paper and steel)	2,589,331 (8,0%)
Machinery and transport equipment	9,106,586 (28,2%)
Miscellaneous manufactured articles (e.g. clothing and footwear)	3,275,811 (10,1%)
Commodities not classified elsewhere (e.g. postal packages)	27,731 (0,1%)
Total	32,326,217 (100%)

Table 3: Exports of goods to the UK, values per category  
CBS Statline (2011)

The total value of Dutch services exports to the UK is smaller than the total value of Dutch goods exports to the UK. The Dutch exports of services to the UK are valued at €9 billion by CBS Statline (2010), that is approximately 10% of total Dutch exports of services. The following table demonstrates the most important categories are transport services and ‘other business services’.

Category	Exports value (thousand Euros)
Transport services (e.g. carriage of passengers and goods)	2,637,000 (29,6%)
Travel (e.g. goods and services purchased by travellers)	1,139,000 (12,8%)
Communication services (e.g. postal and courier services)	323,000 (3,6%)
Construction services	201,000 (2,3%)
Insurance services	21,000 (0,2%)
Financial services	137,000 (1,5%)
Computer and information services (e.g. data processing)	508,000 (5,7%)
Royalties and license fees	535,000 (6,0%)
Other business services (e.g. architects and engineers)	3,176,000 (35,6%)
Personal, cultural and recreational services	123,000 (1,4%)
Government services, n.i.e. (e.g. transactions by embassies)	123,000 (1,4%)
Total	8,923,000 (100%)

Table 4: Exports of services to the UK, values per category  
CBS Statline (2010)

With respect to foreign direct investment in the UK, statistics by AgentschapNL (2012) demonstrate Dutch investments in the UK amount to €106 billion in 2011, that is 14% of total Dutch FDI. These investments are mainly aimed at British oil- and chemical industries and financial services like banking and insurance firms. In 2009 foreign investments in the UK had a total value of £653.6 billion. The US accounted for 24% of this amount, the Netherlands 17% and France 11%. According to UK Trade & Investment (2012) during the period 2011-2012, 36 Dutch projects have started in the UK thereby creating 5,829 jobs.

### 3.3 Dutch SMEs operating on the British market

Above the international involvement of Dutch SMEs has been described and the economic relationship between the UK and the Netherlands has been depicted. However specific data about SMEs involved in operations in the UK is lacking. An interview by phone with the director of the Netherlands British Chamber of Commerce made clear the exact number of Dutch firms which operate on the British market is unknown. He gives two main reasons for this state of affairs. First, firms do not have to register when they start activities in the UK. Hence, organisations like statistical agencies and governments have no exact data about the number of Dutch firms operating in the UK. Second, if such agencies would register activities of Dutch firms in the UK, gathered statistics would be rapidly outdated as the international activities of firms are highly dynamic and start off and finish frequently. As a result, the number and characteristics of firms that operate in the UK can only be estimated. The Netherlands British Chamber of Commerce estimates about 25,000 Dutch SMEs operate in the UK through non-equity modes and about 600 Dutch firms operate through equity modes in the UK. With respect to the most pivotal industrial sectors in which Dutch SMEs operating on the British market are active, the Netherlands British Chamber of Commerce indicates this is accurately depicted by the general trade flows as visible in paragraph 3.2. Hence especially firms involved in the provision of machines, chemical products, ‘food and live animals’, transport services and ‘other business services’ operate on the British market.

## 4. Methodology

This chapter gives insight in the research methods that are used in this thesis which is concerned with internationalising SMEs. The procedure concerned with the collection of data is outlined in the first paragraph. In paragraph two the research design - a qualitative multiple case study - is outlined and characterised. In the subsequent paragraph the hypotheses are operationalised. The last paragraph evaluates the most important limitations of this study.

### 4.1 Data collection

In this paragraph the research population and the procedure concerned with selecting a research sample is outlined. Following the strategy by which interviewees are selected is explained, and the setup of the questionnaire is described.

#### 4.1.1 Research population and building sampling frames

The previous chapter outlined the reasons why the exact number of Dutch SMEs operating on the British market is unknown. The Netherlands British Chamber of Commerce estimates about 25,000 Dutch SMEs operate in the UK through a non-equity entry-mode and about 600 Dutch firms use a equity entry-mode to operate on the British market. These firms are the population which is researched in this thesis.

As it is beyond the reach of this study to approach all these firms a sampling frame was created. Coviello and Jones (2004) state the development of sampling frames for international business studies generally comes with difficulties because researchers of international enterprises face fundamental challenges concerning the identification and categorisation of firms which operate internationally. For instance, studies of firm internationalisation processes "*often examine multiple forms of mode of entry (as opposed to the export-only approach), and this precludes the use of export directories that bias the results towards export-driven internationalisation*" (Coviello and Jones, 2004, pp; 501). In addition, these authors state the advent of mobile telephony and communication via internet excludes some firms from telephone directories, various privacy acts hinder the identification of internationalising firms and very small (and start-up) firms may be elusive and short lived and may never appear on any formal list. These difficulties also hindered the development of a broad sampling frame for this study.

In order to create a sampling frame for this study, many associations and agencies were asked whether they had databases of exporting Dutch SMEs and Dutch SMEs with a subsidiary in the UK (e.g. Dutch embassy in London, UK Trade & Investment and the NFIA). Unfortunately none of these organisations had an extensive database available. As a result, the researcher build a database using the following three selection criteria:

- Firms should be involved in current international operations in the UK;
- Firms should not employ over 250 staff (in accordance with the definition of SMEs in chapter one);
- Firms should be independent and of Dutch origin (i.e. not subsidiaries of other domestic or international companies, in order to avoid potential resource and cultural influences on decision-making).

These criteria align with the selection criteria used by Bell *et al.* (2004) in their empirical study of 30 SMEs on overall business strategies and patterns, processes and pace of internationalisation.

Firms suitable for the database were identified through a threefold strategy. First the database of Fenedex was consulted. Fenedex is a Dutch association for exporting firms and firms

otherwise involved in international markets with approximately 1,150 members and 4,000 clients (Fenedex, 2012). In this database 42 firms are registered as suppliers which operate on the British market. Through a search of the company websites of these firms it was verified whether they were in fact Dutch, in order to rule out any firms owned by foreign multinationals. Moreover, company websites were used to rule out firms with over 250 employees, as these do not comply with the definition of a SME utilized in this study. In case information about employee-numbers was not available on company websites the website "www.opencompanies.nl" was used for this purpose. This website is managed by Graydon, a Dutch company which offers clients (financial) information about other firms amongst others to judge a firm's creditworthiness (Graydon, 2012). Consequently Graydon is well-informed about firm characteristics like employee-numbers. After both foreign firms and firms with over 250 employees were ruled out, 26 firms of which 23 operate on the British market through a non-equity entry-mode and three through an equity entry-mode remained.

The second used source was the list of members of the Netherlands British Chamber of Commerce. This list comprises 184 firms of which 75 are non-Dutch and registered in the UK (72), Germany (1), France (1) and Malta (1). These foreign firms were removed, and of the resulting firms the company websites were researched to further rule out both firms which are part of foreign multinationals and firms with over 250 employees. Again, in case a company website lacked information about employee numbers the website "www.opencompanies.nl" was used. In addition, non-profit organisations like sector associations (e.g. Metaalunie) and Chambers of Commerce (e.g. Kamer van Koophandel Brabant) were removed from the list. Ultimately the list of members of Netherlands British Chamber of Commerce was reduced to 31 SMEs using low-control entry-modes and four firms using high-control entry-modes to operate on the British market.

The third way by which SMEs operating in the UK were identified was through searching the internet. This approach resulted in the identification of 29 additional SMEs of which 18 use low-control entry-modes and eleven make use of high-control entry-modes to operate in the UK.

#### 4.1.2 Characteristics sampling frames

The threefold strategy described above led to a sampling frame of 72 SMEs involved in the UK through non-equity entry-modes and a sampling frame of 18 SMEs using equity entry-modes to operate on the British market. The following table gives an overview of the characteristics of both sampling frames. As only 90 SMEs are included in sampling frames, simple classifications are used.

Characteristics	Non-equity entry-modes	Equity entry-modes
Size: small (0-100 employees)	60 (83.3%)	8 (44.4%)
Size: medium (>100 employees)	12 (16.7%)	10 (55.6%)
Sector: manufacturing	29 (40.3%)	7 (38.9%)
Sector: services	43 (59.7%)	11 (61.1%)
Age: young (0-3 years)	0 (0,0%)	0 (0,0%)
Age: medium (3-25 years)	28 (38.9%)	5 (27.8%)
Age: old (>25 years)	44 (61.1%)	13 (72.2%)
Number of SMEs in sampling frame	72	18

Table 5: Characteristics sampling frames

Next to much cited features like size and sector, the age of the firms in both sampling frames is on display. The reason is while there are no explicit theoretical grounds which suggests differences in internationalisation processes between medium-aged SMEs which use non-equity entry-modes and medium-aged SMEs which use equity entry-modes, theory does suggest that the length of a firm's foreign operations could be related to its performance and entry-mode choice as a result of learning processes (Woodcock *et al.*, 1994). In this regard, Basile *et al.* (2003) state firm age could be a proxy for the international experience that is accumulated through learning processes.

Table five shows that small-sized firms make up a larger share of the sampling frame with SMEs that use non-equity entry-modes than of the sampling frame with SMEs that use equity entry-modes. With respect to industrial sector, both sampling frames include more SMEs from the service sector than from the manufacturing sector and regarding age, old firms are dominant in both sampling frames. The most striking feature of table five is that, of a total of 90 SMEs, none is younger than three years. This indicates that internationalisation processes resembling born globals (Knight and Cavusgil, 2004), are not included in these sampling frames of SMEs which internationalise to the UK. This could indicate a selection bias with consequences for the external validity of this thesis (see §4.1.3)

In order to find out whether any statistical relationships exist between entry-modes and firm characteristics in terms of size, sector and age, three chi-square tests were executed (appendix 1). First, with respect to firm size, medium-sized firms make up a significantly larger share of the sampling frame of SMEs which use equity entry-modes than of the sampling frame of SMEs which use non-equity entry-modes (significant at the 0.01 level). This could be explained by the fact that firm size is positively related to resource availability (Dickson *et al.*, 2006). Medium-sized firms face less resource constraints and are therefore better able to employ equity entry-modes which require more extensive resource commitments. Second, with respect to industrial sector there are no significant differences between both sampling frames. Third, regarding age, it was not possible to execute a full chi-square test because the values for young firms are zero, and therefore the conditions for chi-square tests are not completely satisfied (De Vocht, 2008). When focussing specifically on medium-aged and old firms, a chi-square test demonstrates there is no significant difference between both sampling frames. Hence in these sampling frames, firm age is not a proxy for international experience which results in the use of equity-entry-modes by old SMEs. In sum, the SMEs in both sampling frames are similar with respect to sector and age, yet they differ in terms of firm size.

#### **4.1.3 Sample selection and validity**

Rich and deep information is required in order to understand the motivations on which SMEs select host countries and entry-modes for their internationalisation. Moreover, detailed information is essential in order to get a thorough understanding of learning processes. Due to time- and resource-constraints it is not possible to approach all firms in the sampling frames. Coviello and Jones (2004) indicate that in these cases, it is most pragmatic to use non-probability samples provided the sampling criteria are well and consistently specified and the data are assessed for validity and reliability. This approach is followed in this study.

Through purposeful sampling a research sample of nine firms was selected. Coviello and Jones (2004) state such a small set of case studies is appropriate when the research problem necessitates rich, deep information and extensive generalisability is not assumed. The size of this thesis' sample fits the general pattern of international entrepreneurship literature which, according

to Coviello and Jones (2004), suggests that 3-30 firms are studied. For example, influential studies like Coviello and Munro (1997), Crick and Spence (2005) and Chetty and Campbell-Hunt (2003), conduct in-depth, qualitative research of respectively four, twelve and ten internationalising firms.

The objective of this purposeful sampling strategy is to establish a good correspondence between research questions and sampling (Bryman, 2008), and to create a sample which represented wide heterogeneity in terms of entry-modes, sector, age and size. Evidently all selected firms are of Dutch origin, employ a maximum of 250 staff, and operate on the British market. In order to get a balanced understanding of entry-mode choices, five firms which use non-equity entry-modes and four firms which use(d) equity entry-modes were selected. With respect to firm size and industrial sector, five small-sized and four medium-sized firms were selected and the same proportion was adopted for firms involved in services and manufacturing. Regarding age, the firms that are selected in this thesis' research sample are of medium age (three firms) and six firms are regarded as old. Below the characteristics of the research sample in relation to both sampling frames is shown.

Characteristics	Sampling frame non-equity entry-modes (research sample)	Sampling frame equity entry-modes (research sample)
Size: small (0-100 employees)	83.3% (4)	44.4% (1)
Size: medium (>100 employees)	16.7% (1)	55.6% (3)
Sector: manufacturing	40.3% (2)	38.9% (2)
Sector: services	59.7% (3)	61.1% (2)
Age: young (0-3 years)	0,0% (0)	0,0% (0)
Age: medium (3-25 years)	38.9% (1)	27.8% (2)
Age: old (>25 years)	61.1% (4)	72.2% (2)
Number of SMEs	72 (5)	18 (4)

Table 6: Characteristics sample

The sample covers the variation in both sampling frames well. More elaborate descriptions of the selected firms are provided for in the following chapter.

All selected SMEs operate on the British market for over a year. As this thesis' main research topics are host-country choices and entry-mode choices - which both occur at the initial phase of internationalisation processes - a minimum period of one year is considered appropriate. With respect to the third hypothesis, which is concerned with learning processes, a one year period is also considered suitable as SMEs engage in learning processes from the inception of their activities on the British market and intend to optimise their international operations from the start. In addition, given the fact four interviewed SMEs operate in the UK for over ten years, any long term learning processes are also comprehensively researched.

As business phenomena take place in a rich context, (international) business research has to consider many variables, and for that reason requires large samples in order to generalise findings (Johnston, 1999). The size of this thesis' research sample is limited, and it is therefore important to carefully determine the external reliability of this study. External reliability is concerned with the question of whether the results of a study can be generalised to beyond the specific research context (Bryman, 2008).

With respect to this study, the composition of this study's research sample limits the generalisability of the findings to SMEs which specifically internationalise to UK, because the cross-cultural generalisability of samples which include specific host-countries or cultures is limited (Coviello and Jones, 2004). Moreover, as only Dutch SMEs are included in the sample, it is not viable to generalise this study's findings to non-Dutch SMEs that engage in internationalisation processes. Moreover, the limited size of this thesis' sampling frames causes a lack of insight into the features of the complete population of Dutch SMEs that internationalise to the United Kingdom. As there are no external sources available that supply this information, the precise representativeness of the results of this thesis is difficult to determine. This is aggravated by the limited size of the research sample. However in this study, detailed and profound research is preferred to wide generalisability. The results of this thesis' are therefore considered indicative for the population of Dutch SMEs that internationalise to the UK.

Further quantitative research is required to enhance the generalisability of the findings of this study. In this light, Sullivan Mort and Weerawardena (2006, pp: 568) state: "*results of studies using case study methods should be followed by wider empirical tests using probability sampling frames*". Hence for further studies on internationalisation processes it would be recommendable to use probability sampling techniques instead of purposeful sampling techniques which are used in this study, in order to increase the generalisability of any results.

With respect to internal validity, a concept concerned with the question whether "*there there is a good match between researchers' observations and the theoretical ideas they develop*" (Bryman, 2008, pp: 376); the intensive contact between researcher and research object by means of semi-structured interviews (more in §4.2), ensures the researcher can achieve a high level of congruence between concepts and observations. The internal validity of this study is therefore considered good.

#### **4.1.4 Selection of interviewees and the questionnaire**

This study is concerned with Dutch SMEs which operate in the UK. Consequently, keypersons who represent such SMEs are most suited for interviewing. Keypersons are those who are personally involved in managing a firm's operations in the UK. In all contacted firms, the person responsible for sales in the UK was requested to cooperate. If this person was unavailable, the question was asked whether someone was available who has knowledge about the firm's international operations. For purposes of methodological transparency, both the function of the interviewee and the characteristics of the SMEs which the interviewees represent are discussed in chapter 5.1. The interviews had an average length of 45-60 minutes with extremes of 30 minutes and over two hours. Two interviews were conducted by phone and seven interviews were conducted face-to-face at the offices of the firms concerned. None of the interviews has been recorded to ensure the confidentiality of the interviewed firms and their internationalisation strategies. This deliberation also resulted in the decision to refer to specific firms as firm A, firm B, etc. in this thesis. In order to limit any loss of data, all the interviews have been transcribed directly after the interview. Subsequently the results were send to the interviewee by email, who then could check them and add comments on matters that were incorrect or incomplete. In addition, if certain aspects of the interview turned out to be unclear during the transcription process, additional questions were added to the email in order to clarify the subject.

Prior to interviewing, the researcher set up a questionnaire encompassing 24 questions. This questionnaire is enclosed as appendix two in order to enlarge the transparency and replicability of



this study (Bryman, 2008). The questionnaire was drafted in Dutch language as all interviewees are Dutch. The questionnaire's structure was as follows, first some general questions about the firm were asked, for instance concerning the core business of the firm, the countries in which the firm operates, and the number of employees. Second, the focus was on the motivation behind a firm's choice for the UK and the utilized entry-mode. Questions were asked about the firm's general approach towards the selection of both host countries and entry-modes. In addition, the specific motives behind both a firm's choice for the UK as a host country, and the operational mode that the firm used to enter the UK, were inquired about. Firms were also asked whether they anticipated and experienced any problems/delays when they internationalised to the UK. Third, the focus was on processes which firms went through when they internationalised to the UK. The way in which firms obtained information about the UK with respect to rules and regulations, norms of stakeholders and the local (business) culture was discussed. Attention was also paid to the ways in which firms adapted to these characteristics of the UK. Finally, the interviewees were asked about the role of networks in the internationalisation process of their firm, and whether they had any advice for firms with intentions to enter the British market.

#### **4.2 Qualitative research approach**

The focal points of this study are Dutch SMEs which operate in the UK. To understand the decisions and the behaviour of these firms, a multiple case study design is considered most appropriate. The case study is a research design which is focused on understanding the dynamics present within single settings (Eisenhardt, 1989). According to Halinen and Tornroos (2005, pp: 1286), a case study is *"a strong method in the study of change processes as it allows the study of contextual factors and process elements in the same real-life situation"*. As internationalisation processes are dynamic, change processes, a case study is therefore the most appropriate research design when studying this phenomenon. In this thesis, multiple case studies are executed to ensure the researcher can discover differences and patterns between firms. The main disadvantage of the use of multiple case studies is their limited appropriateness to underpin generalisations. However, as the key goal of this study is to understand the dynamics of internationalisation processes, and discover patterns and differences, a qualitative case study research design is considered most appropriate. This research design makes sure the researcher can achieve sufficient analytical depth, and consequently gets a thorough understanding of the internationalisation processes in which SMEs engage.

Semi-structured interviews are the most suited research method to get such an understanding of firm internationalisation processes, because this method allows the researcher to gain insight in the perceptions and experiences of the interviewees. Moreover, because internationalisation processes are highly firm-specific, semi-structured interviews are the most appropriate research method for this thesis as they enable a researcher to pick up those specifics. In accordance, with respect to international business research, Yeung (1995) states qualitative personal interviews can offer much depth and richness in collected data. Furthermore, the use of semi-structures interviews leaves room for interaction between interviewer and interviewee. Clark (1998, pp: 73) depicts the use of interviews in a case-study research design as a 'close dialogue': *"Close dialogue is a mode of case study research, one that uses structured and unstructured interviews in the context of relationships between nominal equals to reveal the actual logic of decision making"*. Interviews give a researcher flexibility to ask additional questions. Conducting interviews therefore provides more information to researchers than, for instance, carrying out surveys. The use of semi-structured interviews assures the researcher can obtain information concerning his topics of interest

without forcing the interviewee into a strict framework. As internationalisation processes are firm-specific, it is important to allow the interviewee to discuss the issues he/she thinks are important.

This deliberation also led the researcher to use open questions. By making use of this type of questions the researcher is ensured his topics of interest are discussed, while interviewees have the opportunity to further elaborate on particular issues. Vinten (1995) states the use of open questions has benefits with respect to testing hypotheses about ideas and awareness. This is an advantage in this thesis since it is concerned with motives behind SME internationalisation behaviour. Furthermore, Vinten (1995) states that by asking open questions, the interviewer is ensured answers are not biased as is the case with (categorised) closed questions. Nonetheless, the use of open questions has disadvantages as well. For example, answering open questions is time-consuming and therefore requires more time from respondents. Moreover, processing answers is more difficult and group comparisons are harder when using open questions in comparison with closed questions (Vinten, 1995). Nonetheless, with respect to this study, the advantages of open questions are considered to be larger than its disadvantages. This is in accordance with Yeung (1995), who states the advantages of qualitative personal interviews outweigh its disadvantages when researching the behaviour of internationalising firms.

### 4.3 Making the hypothesis operational

In the empirical part of this study, the hypotheses formulated in chapter two are researched. In order to be able to do so, the key concepts have to be defined and made operational. The key parts of the hypotheses concern the characteristics of learning processes which reduce Dutch firms' 'liabilities of foreignness' in the UK. Firms are supposed to learn about:

- Market characteristics. These institutions influence a firm's foreign operations. For instance, a firm might have to adapt its product to comply with certain government-set product-demands like product safety regulations and regulations which apply to exports to the UK. These themes are discussed with interviewees.
- Norms of stakeholders in the UK. Norms of stakeholders are related to stakeholders' desirable goals and the appropriate means of attaining them (Xu and Shenkar, 2002). Interviewees are asked whether UK stakeholders (e.g. other firms, governments and consumers) are different in this respect to Dutch stakeholders. Subjects like trust, reliability, the use of contracts and any prejudices towards foreign firms are discussed. As a variable for norms, other studies often make use of data about corruption (e.g. Fisman and Miguel, 2007), subsequently this subject is also discussed with the interviewees.
- Local (business) culture in the UK. Interviewees are asked whether the (business) culture in the UK is different from the Netherlands'. Culture relates to the cognitive pillar of institutional environments and highlights the internal representation of the environment by actors (Xu and Shenkar, 2002). Consequently, this study aligns with Sullivan and Katz-Gerro (2007) by defining culture as: *"a repertoire of habits, skills, and styles from which people construct their understanding of the world and how to conduct themselves in it"*. The interviewees are asked whether stakeholders in the UK differ from stakeholders in the Netherlands with respect to habits, skills and styles.

Therefore, with respect to the hypotheses, the central topics addressed in interviews are:

UK market knowledge	UK norms of stakeholders	UK local (business) culture
Regulations	Trust	Habits
Export requirements	Use of contracts	Skills
Product requirements	Corruption	Styles
	Reliability	
	Prejudices towards foreign firms	

Table 7: Topics addressed in interviews

**Hypothesis 1:** Dutch SMEs internationalise to the UK since it is an institutionally close host country where these SMEs face limited liabilities of foreignness.

- To research this hypothesis, interviewees are asked why the SME they represent chose the UK as host country for its internationalisation. Additionally interviewees are asked whether specific market knowledge is required to operate in the UK, if British stakeholders have other norms than Dutch stakeholders and whether there the UK has a specific (business) culture. Interviewees are asked if they had to adapt to certain characteristics of the UK and the ease of such an adaptation. The answers are related to liabilities of foreignness which firms face when they start operations abroad. Subsequently a link is made between these liabilities of foreignness and institutions. Moreover, interviewees are asked whether they encountered problems or hold-ups when internationalising to the UK. For instance, a firm could have experienced some difficulties with creating a legal form for their UK-activities (e.g. a Limited) or with attracting British clients being a foreign company. Naturally, a firm's strategy to deal with these problems is also discussed.

**Hypothesis 2:** Dutch SMEs that internationalise to the UK are able to use equity modes to enter the British market as the UK is institutionally close to the Netherlands, which causes these SMEs to face limited liabilities of foreignness in this country.

- Interviewees are asked on what grounds the choice for a certain entry-mode of the SME they represent was based. Additionally interviewees are asked whether specific features of the UK that are related to market characteristics, norms of stakeholders and local (business) culture influence their SME's international strategies. The answers are linked to the liabilities of foreignness which firms face abroad and subsequently to the three pillars of an institutional environment. For instance, an interviewee could state the firm he/she represents entered the UK through direct exports, and had formal agreements with partners in the UK previous to internationalising. Hence with respect to 'liabilities of foreignness'; the firm concerned experienced few relational and discrimination hazards. It is therefore most likely this firm perceived limited risk with respect to enforcing a contract (normative and regulative pillar), and could deal with any cultural differences (cognitive pillar).

**Hypothesis 3:** Dutch SMEs that internationalise to the UK engage in internal learning processes ('learning by doing') and external learning processes ('learning by interacting with partners') to obtain market knowledge and knowledge about both norms of stakeholders and local (business) culture.

- To research this hypothesis, interviewees are asked how they obtained market knowledge and knowledge about both norms of stakeholders and local (business) culture. For example, how do Dutch SMEs assess the trustworthiness of British business partners? The answers are subsequently related to internal learning processes (learning by doing), and/or external processes with partners either abroad or in a firm's local environment. Moreover, questions with respect to the importance of trade fairs and network events are asked.

#### 4.4 Limitations of this study

This study is aimed at providing an in-depth understanding of firm internationalisation processes to the UK. While the use of semi-structured interviews in a multiple case study is the most suitable research method, this method also comes with some shortcomings.

First, the use of multiple case studies is aimed at analysing and understanding a small number of cases, and is therefore not representative for a larger population (Bryman, 2008). It is therefore difficult to generalise the findings of this study. This also means a definite rejection of a hypothesis is not always possible. Yet it is possible to shed light on affairs on which a profound understanding is missing. Moreover, the in-depth study of cases enables a researcher to pay attention to details and firm-specific contexts which could provide new insights on the subject and new openings for further research. Further quantitative research could provide results which generalisability is higher. Chaston *et al.* (1999) share this notion by stating that research on learning processes is mostly based on qualitative observations, and quantitative data is needed to statistically determine the validity of claims that are concerned with learning processes (and organisational performance).

As this study is concerned with firms which operate in the UK, this limits the generalisability of the results of this study to Dutch SMEs that operate in the UK. The findings of this study are therefore not applicable to Dutch firms which operate in other countries than the UK; answers of interviewees could differ when firms are engaged in international operations in other countries. With respect to industrial sectors, the cases of this study operate in various sectors which makes the group heterogeneous. In this way more variety is revealed and the researcher is enabled to get a more comprehensive understanding of firm internationalisation processes.

Another limitation of the use of semi-structured interviews is the fact it is associated with personal interpretations. For instance, there could be dissimilarity between the interpretation of an interviewee who has been involved at a firm's operations in the UK from the start and perceptions of individuals who are involved in such operations for only one or two years. Yet, this is inevitable as otherwise this study would have been founded on an inadequate number of interviews. Personal interpretations are also by definition coloured by a person's perception and memory. However, it is reasonable to assume a person would remember the most significant events of a firm's internationalisation process.

Finally, this study has a selection bias as only successful internationalisation processes are analysed. Firms that could not adapt to the British institutional environment are therefore not included in the sample. The institutional distance between the Netherlands and the UK could have proven itself too high for these firms. For that reason would it be interesting for further research to analyse these unsuccessful internationalisation processes.

## 5. Analysis: Dutch SMEs internationalising to the UK

This chapter provides the analysis of the internationalisation processes of the selected SMEs. First, the characteristics of the selected SMEs of which representatives are interviewed are described. Second, the processes by which the interviewed SMEs selected the UK as host country are analysed. Third, the underlying logics by which the interviewed SMEs chose a certain entry-mode are analysed. In this paragraph, the liabilities of foreignness the selected SMEs face, and their strategies to deal with them, are also reviewed. Finally, the role of direct personal contact in firm internationalisation processes is discussed.

### 5.1 Characteristics of the SMEs interviewed

Below a short introduction is given for every interviewed SME. Attention is paid to characteristics like industry, size and the operational mode through which these firms operate on the British market. The information originates mainly from the interviews. In addition, occasionally company websites of the SMEs concerned were consulted to obtain additional information.

#### 5.1.1 SMEs operating through non-equity entry-modes

**Firm A** is an architectural firm which is founded in 1984, currently has about 90 employees and operates in various countries. The firm is responsible for the designs of several foreign projects in, for instance, the USA, Taiwan, Mauritius and South-Korea. From 2008, firm A is involved in a large construction project in the UK (budget >£150 million). The interviewee is a Dutch associate architect who is stationed in the UK.

- Entry-mode: Firm A has an office in the Netherlands and exports its services to the UK. In addition, the firm has stationed an employee - a Dutch associate architect - in the UK.

**Firm D** is a producer of (oven-baked) savoury and sweet snacks. The firm is founded in 1849 and has nearly 100 employees. The most important foreign markets for firm D are France and the UK. Sales in France alone account for 60% of firm D's turnover. Approximately 90% of firm D's turnover comes from the Netherlands and eight foreign markets. The interviewee is commercial manager at firm D.

- Entry-mode: Firm D started operations in the UK through a distributor and after a while moved on to engage in a contractual partnership with a British firm. Hereafter, firm D switched once of partner-firm.

**Firm E** develops and produces sorting machinery for fruit and vegetables. From the start in 1940, the firm has grown to become the employer of roughly 190-200 persons at this moment. Firm E operates in over 50 countries which include the UK, Germany, South-Africa, the USA, Russia, South-Korea and Australia. The interviewee is export manager at firm E.

- Entry-mode: Firm E started exporting to the UK in the 1950s through an agreement with a agent. Up till now, the firm continued the collaboration with this agent.

**Firm G** is involved in the provision of human resource services. With respect to the firm's international operations, these mainly concern taking care of cross-border payrolls for firms that operate internationally. For example, in case of a German firm which has stationed several employees in the UK; firm G can arrange the cross-border payroll administration for these employees. Firm G is founded in 1972, and currently employs 40 individuals. The firm operates in the

UK, Belgium and France. The interviewee is international payroll manager at firm G and is also a member of firm E's management team.

- Entry-mode: Firm G started operating in the UK in 2002 through partnerships. Currently, the firm has agreements with several British partners which execute the requests of firm G's clients. Interviewee G therefore states firm G mainly acts as an intermediary, and itself does not execute requests which are related to the British operations of clients.

**Firm I** is a publisher of business games, simulations and serious games for educational institutions, companies and governmental organisations. The firm is founded in 2002 and at the moment employs 20 persons. Firm I has an agent in the Caribbean and incidentally supplies clients in Belgium and Germany. The interviewee is commercial director of firm I and co-owner the joint-venture by which firm I operates on the British market.

- Entry-mode: Firm I started operations in the UK through exports. However, some time ago the firm decided it wanted to apply a more strategic approach. Subsequently, in January 2012 firm I founded a joint-venture in collaboration with an employee through which it currently operates in the UK. At the moment, this joint-venture is involved in a partnership with a major British publisher in order to develop a new product for the British market.

### 5.1.2 SMEs operating through equity entry-modes

**Firm B** is a mobile virtual network enabler (MVNE) that is founded in 2008 and currently employs about 50 persons. The main competitors of firm B in the Netherlands are well-known firms like KPN and Vodafone. The main difference between these two firms and firm B is the fact firm B does not own and manage a mobile radio network, yet it leases access from other firms. Firm B provides the intelligence that enables other firms to act as a mobile virtual network operator. For instance, the firm was hired by another firm to create the possibility to make calls between the Netherlands and Suriname for a local rate instead of a higher international rate. Moreover, firm B assists clients which want to make use of mobile phones for loyalty programmes or other purposes. Firm B operates in the UK and Poland. The interviewee is financial manager at firm B.

- Entry-mode: In 2010, firm B started its operations in the UK through the exports of its services. However, since early 2012 the firm hires a small office from which two British sales freelancers operate on the British market on firm B's behalf.

**Firm C** is a producer of ergonomic office chairs. The firm is founded in 1988 and currently has about 110 employees. Next to the UK, firm C operates in Belgium, France, Finland, Germany and Ireland. The interviewee is managing director at firm C.

- Entry-mode: Firm C started operating in the UK in 1999 through a joint-venture with a former employee in which firm C controlled 70 percent of total shares and the former employee controlled 30 percent. In 2008 the firm made an acquisition and took over a British firm with 45 employees. At this time, this subsidiary has 20 employees.

**Firm F** is a developer and producer of underfloor heating and cooling systems. The firm is active since 1986 and currently employs a little over 100 persons. For approximately 15 years firm F is operating on international markets and the firm has been involved in the UK, India, Spain, Ireland and Belgium. The interviewee is the director of firm F.

- Entry-mode: Firm F started its operations on the British market 15 years ago through an agent. In 2005, firm F took over this agent and subsequently served the market through a subsidiary which had about 18 employees. In 2011 firm F sold this subsidiary, which afterwards started to work again as firm F's agent in the UK.

**Firm H** is involved in a broad range of activities ranging from projects in the area of earthworks, civil engineering, waste collection and processing, biomass and plastic recycling. The firm is founded in 1945 and has 250 full time employees. Firm H's international operations are primarily concerned with plastic recycling. The firm supplies recycled plastics to all countries in West-Europe, and collects plastic waste in the UK, Belgium and Denmark. The interviewee is managing director of firm H.

- Entry-mode: In January 2012, firm H entered the British market through a joint-venture in conjunction with a British partner. However, after three months the British firm concerned withdrew itself from the joint-venture, and subsequently firm F independently manages a subsidiary in the UK. One employee of this subsidiary is on firm H's payroll, and 43 persons are additionally hired.

## 5.2 Host country selection processes

Interviewee A states **firm A** does not consider any country-specific characteristics when it chose to enrol in a tender for a project in the United Kingdom.

*"We do not specifically select foreign countries where we want to design projects. For us, it is most important a project is interesting, regardless of any country-specific characteristics" (Interviewee A, June 2012).*

The fact firm A is involved in projects located in Taiwan and South Korea - Asian countries whose variety of economic organisation differs strongly from Europe's (Whitley, 1998) - also indicates firm A's choice of host countries appears not to be influenced by the institutional distance to a particular country. Hence firm A's choice to get involved in the UK was not influenced by a desire to limit its liability of foreignness.

The foreign markets in which **firm B** operates are the UK and Poland. With respect to starting activities in the UK, firm B was negotiating with potential clients from several countries, and the process concerned with signing a contract went most fast with the UK-division of a well-known multinational; henceforth firm B started activities in this nation. The pace with which firm B and this client went through the contracting process was high because firm B collaborates with the Dutch division of this multinational, and they proved to be a positive reference. Moreover, in the past two employees of the UK-division of the multinational in question have worked for the Dutch division of the same multinational. Here they personally collaborated with firm B. Interviewee B states this enhanced the speed of the contracting process as well. Consequently firm B's choice to sign a contract with a client in the UK seems to originate primarily from the fact firm B was well-known to the Dutch division of the multinational concerned and considered this firm trustworthy.

With respect to **firm G**; the main clients of this firm are large, foreign companies which outsource HR services for employees which are stationed abroad to local partners. The clients for which firm G provides HR-services requested the firm to provide these services also in the UK. At a certain point, the number of these requests reached such proportions that firm G decided to

comply, and subsequently the firm started operations in the UK. Hence the internationalisation of firm G to the UK is an explicit example of client-followership (Bell *et al.*, 2001).

**Firm E** started exporting to the UK in the 1950s. At that time, a Dutchman emigrated to the UK and he started to act as an agent for several Dutch firms amongst which firm E. Ever since, firm E is working with this agent to the satisfaction of both parties. Hence, in case of firm E's activities in the UK, firm E's procedure concerning both market selection and entry-mode choice had an unplanned nature. The case of firm E therefore corresponds to literature which states it is not uncommon for SMEs to demonstrate unplanned behaviour where firm management reacts to opportunities as they present themselves (Crick and Spence, 2005). According to interviewee F, this is also the strategy by which **firm F** selects foreign markets. He states strategically planned internationalisation processes are costly and time-consuming. As firm F currently does not have the required resources to engage in such a process, firm F reacts to foreign requests and does not plan entries in particular foreign markets. With respect to this firm's choice for the UK as an host country; firm F started operations in the UK because it was contacted by a British firm which requested to become firm F's agent in the UK. Hence, firm F did not actively pursue international opportunities in the UK and did not strategically evaluate various international markets.

The cases of firm B, firm G, firm E and firm F are interesting as they highlight the importance of network-relationships in explaining internationalisation processes. This finding is in accordance with Coviello and Munro (1997), who state firm growth in foreign countries is often the result of a firm's involvement in international networks. Major partners frequently guide foreign market selection and provide the mechanism for market entry. These authors state that as a result, network relationships can not only drive internationalisation, but also influence the pattern of market investment. This is especially apparent for the cases of firm E, firm F and firm G which were requested by other firms to internationalise to the UK. The cases of firm G and firm B align with the conception of Bell *et al.* (2001), who indicate it is not uncommon for firms to follow existing clients abroad. These authors state such behaviour is widespread among firms that operate in small open economies and in emerging nations, where domestic demand may be limited.

The cases of firm E and firm F reveal that the international involvement of SMEs is not always the result of elaborative strategic planning (Crick and Spence, 2005). According to Bell *et al.* (2003), especially SMEs that are involved in traditional manufacturing tend to adopt an *ad hoc*, reactive and opportunistic approach to internationalisation. However, while firm E's internationalisation to the UK in the 1950s was unplanned, the firm nowadays plans and evaluates market entries. The firm drafts export strategies and executes market research in order to strategically plan its international activities. As firm E currently is larger than at the start of its operations on the British market in the 1950s, this suggests a positive relationship between firm size and strategic planning of internationalisation processes. Bonaccorsi (1992) also finds this relationship, and elaborates on this finding by stating that small firms may not adopt a sophisticated export strategy, yet they can sustain a strong export commitment based on their general resources and competitive factors. For example, with respect to small Italian exporters, Bonaccorsi (1992) observes relatively weak export strategies within small firms, which is however more than compensated for by the strong basic competitiveness of these firms. Hence export strategies are not a prerequisite for successful internationalisation processes.



**Firm C** strategically evaluates foreign markets when it intends to sell the ergonomic office chairs it produces abroad. The firm makes use of two main requirements when it selects a foreign host country; there should be enough interest in ergonomic chairs in the country concerned, and transport costs should be relatively low. With respect to the UK, these two features were explored by firm C, and subsequently the firm decided to start operations in the UK. **Firm D** utilises a similar strategy, it selects foreign markets after exploring the potential interest in savoury and sweet snacks, and the ease of entering agreements with major retailers. The UK proved positive on both criteria, and subsequently firm D started activities in this country.

The host market selection strategy of **firm H** entails a evaluation of governmental waste policies. That is to say, the waste recycling services which firm H offers are generally more costly than the incineration and dump of waste. When governments introduce taxes and levies which increase the costs of the incineration and dump of waste, at a certain moment a break-even point is reached after which firms H's services are not only attractive from an environmental point of view, but also from a cost perspective. In the past, the British government introduced a dumping tax which stepwise increases the costs of dumping waste from £20 per ton to £70 per ton. In January 2012, the break-even point for firm H's services was reached, and the firm subsequently decided to start operations in the UK.

**Firm I** started operations in the UK for a number of reasons. First, the distance between the Netherlands and the UK is relatively small which minimises logistical costs. Second, educational institutions - the main target group for firm I - are numerous and large in the UK, which ensures the firm can achieve an appealing turnover in the UK. Third, the British language is relatively easy to understand which simplifies both the translation of firm I's products and doing business in the UK. Besides these rational considerations, interviewee I states he considers the British culture appealing, and he indicates this was an element that got into the decision to start operations in the UK.

Hence firm C, firm D, firm H and firm I strategically evaluated foreign markets when they chose to start operations in the UK. However, as SMEs generally lack information and resources (Johanson and Vahlne, 1990; Andersen and Buvik, 2002), they often cannot engage in a rational decision-making process in which a wide variety of options is evaluated. Behavioural economists like Simon (1972) point to the fact decision-makers do not make optimal decisions - as a result of risk and uncertainty, incomplete information about alternatives, and complexity - and often resort to options which satisfy their minimal requirements. With respect to firm internationalisation processes, Erramilli (1991, pp: 494) builds on this notion by stating: *"Firms perceiving high degrees of uncertainty due to inexperience are more likely to enter markets about which they have the best information"*.

Consequently firms are most likely to internationalise to counties about which they have superior market knowledge and are familiar with reliable business partners. Generally network-partners are responsible for the provision of new knowledge about both market characteristics and potential clients, thereby ensuring internationalising SMEs face limited liabilities of foreignness. Network-partners can therefore be understood to guide foreign market selection and influence the pattern of foreign markets served by SMEs (Coviello and Munro, 1997).

### **5.3 Liabilities of foreignness, leaning processes and entry-mode choices**

Firms starting operations abroad face liabilities of foreignness which consist of unfamiliarity hazards, discrimination hazards and relational hazards (Eden and Miller, 2004). Both the implications of these

hazards for the interviewed SMEs and their strategies to deal with them are analysed below. The relationship between liabilities of foreignness and entry-modes receives particular attention.

### 5.3.1 Serendipity and entry-mode strategies

The interviews made clear that as with host country choices, not all firms strategically evaluate entry-mode options. This is manifested most clearly in the cases of **firm E** and **firm F**. The first entered the British market around 1950 with an agent who was a Dutchman who emigrated to the UK and suggested to act as an agent for several Dutch firms, amongst which firm E. Ever since, firm E enjoys a satisfactory collaboration with this agent. In the late 1990s, firm F was contacted by a British company which wanted to act as an agent for firm F. Firm F agreed and consequently started operations of the British market. In 2005, the director of firm F's agent retired and firm F could take over this firm. The firm decided to make use of this opportunity, and subsequently purchased its agent. The cases of firm E and firm F are in accordance with Hutchinson *et al.* (2005) and Crick and Spence (2005), who indicate that the involvement of SME in international markets is often the result of unplanned, reactive and opportunistic decision-making.

As internationalisation processes are accompanied with transaction costs, numerous SMEs are unable to strategically plan their international activities because of resource constraints. As a result, these firms react to foreign requests because this allows them to avoid learning processes through which market knowledge is acquired, and more importantly, potential business partners are identified. SMEs which do possess resources can engage in more rational internationalisation processes in which they strategically assess various entry-mode options. In these assessments, SMEs are able to take liabilities of foreignness into account. Yet as internationalisation processes are diverse, the importance that firms attach to the reduction of unfamiliarity hazards, discrimination hazards and relational hazards differs among firms. Consequently, the desire of firms to reduce certain hazards are achieved through choices for particular entry-modes, while other hazards are mainly reduced through the implementation of additional strategies. Both are discussed below.

### 5.3.2 Unfamiliarity hazards

Foreign firms lag behind local firms with respect to market knowledge (Eden and Miller, 2004). This causes foreign firms to experience unfamiliarity hazards. Firms can obtain information to overcome these hazards in several ways. For example, **firm B**, a mobile virtual network enabler (MVNE), hired a Dutch consultant who had worked for the Dutch division of the multinational with which firm B intended to sign a contract. This consultant advised firm B about rules and regulations concerned with both the application for a licence in the UK and the use of the mobile radio network of mobile virtual network enablers in the UK. Furthermore, firm B had to set up a Limited (i.e. private company limited by shares) for its operations in the UK. In order to do so, firm B made use of a British firm which was specialised in creating such business entities. This firm was recommended by one of the members of the Supervisory board of firm B. **Firm A**, an architect, used a similar strategy; this firm also hired consultants (e.g. an engineering consultant and a design management bureau) to get informed about the UK. For firm A this particularly concerns knowledge about building regulations and other regulations concerned with construction projects. The same holds true for **firm H**, a provider of recycling services, which hired a respectable legal expert and an accountant in order to comply to British regulations. Firm H was introduced to this legal expert through the British partner with which it initially participated in a joint-venture, and UK Trade & Investment recommended the accountant concerned to firm H. Hence, the essential role of external learning in internationalisation processes is particularly evident in firm H's internationalisation as current network-partners

introduce new business partners to firm H which subsequently provide the firm with relevant knowledge.

**Firm D**, a producer of savoury and sweet snacks, has another strategy to obtain market information. The firm serves the British market through a partnership with a British firm, and this partner informs firm D about relevant issues. For instance, firm D's main clients are retail firms. These firms make use of time windows in which their suppliers have to conform to several requirements. This involves dealing with deadlines about when to provide a retail firm with product recipes and results of laboratory tests. Firm D's partner notifies the firm about these time windows. Moreover, firm D is informed about specific themes which are of interest in the UK by its British partner. This concerns amongst others maximum quantities of fat and salt in food products. Such information is important for firm D as the firm sometimes has to adjust its recipes to comply with these demands. Hence it is important for firm D to have a reliable partner which provides the firm with relevant market knowledge. The same holds true for **firm E**, a developer and producer of sorting machinery for fruit and vegetables, which is informed about market characteristics by its agent in the UK. For example, these include information about the consequences of British health and safety regulations for the design of firm E's products. For instance, the machines produced by firm E often have railings along platforms from which users can screen and select fruits and vegetables. The platform heights from which railings are legally required in the UK differ from their Dutch equivalents. Consequently firm E sometimes has to adapt designs to meet British regulatory standards. Firm E is informed about these regulations by its agent.

**Firm G** provides HR-services which predominantly concern cross-border payroll services. In order to offer these services in the UK, knowledge about British tax-regulations and related laws is essential. As the partners of firm G in the UK possess such knowledge, firm G acts as an intermediary which collects requests/orders of clients and subsequently passes them on. Hence firm G makes use of local knowledge which is available in British firms, in order to reduce unfamiliarity hazards.

According to interviewee I, **Firm I** does not require specific market knowledge as its products only require translation from Dutch to English before they are eligible for export to the UK. Hence apart from language, there are no specific product requirements and regulations to which firm I has to comply in order to be able to serve the British market appropriately. Interviewee I indicates this would also have been the case when firm I would internationalise to other countries as business games are an international product which, apart from language, do not require adjustments to local customs.

With respect to the interviewed firms which use(d) equity entry-modes to operate on the British market; these firms generally hire local employees to ensure sufficient market knowledge is present in their subsidiaries. Interviewee F states for that reason, local employees are essential for Dutch firms which intend to internationalise to the United Kingdom through equity entry-modes. The fact both **firm C** and **firm F** acquired a British firm instead of setting up greenfield ventures is another indication of the value of local market knowledge. By taking over a British firm they purchased existing business relationships and skilled personnel equipped with local market knowledge. These advantages of this type of entry-mode are acknowledged by Glückler (2006). **Firm B** employs British freelancers with experience in the industry in which firm B operates for its small greenfield investment in the UK. Interviewee B explicitly states these individuals are preferred over Dutch employees as they possess knowledge about British market conditions which potential Dutch employees would lack.

**Firm H** set up an equity joint-venture with a British partner partly in order to benefit from its partner's market knowledge. Even though this partner withdrew itself from the joint-venture after three months, interviewee H states the market knowledge and network-relations of this partner have accelerated the pace of the start-up phase of the joint-venture. In addition, he states that after three months, firm H's knowledge of the British market and involvement in British networks had reached a sufficient level for firm H to operate on the British market independently. This finding corresponds to the findings of Moolenaar (2011), who indicates internationalising firms attach more importance to external advice concerned with obtaining market knowledge and information about potential new business partners during settlement stages than during operational stages.

Concluding, the interviewed firms recognize the fact they lack market knowledge compared to British firms. The primary modes of the interviewed firms to overcome this lag in market knowledge is to use contractual agreements as entry-mode, to hire consultants/legal experts and to employ local employees in their subsidiaries. Hence obtaining market knowledge appears to be mainly an external learning process. The role of business interactions in obtaining market knowledge is confirmed by Johanson and Vahlne (1990). Market knowledge is stored in firm routines and individuals (Sharma and Blomstermo, 2003). As a result, information gathered in the past by both firms and individuals, comes to use in their current activities. This also holds true for the interviewed firms. For example firm A, currently this firm does not experience extensive unfamiliarity hazards in the UK, as in the past firm A was responsible for the design of a small-scale housing project in the UK. This project provided the firm with valuable knowledge about (formal) rules and regulations which govern the UK. Interviewee A states that when they work on their current project in the UK, this knowledge turns out to be very useful and ensures his firm avoids problems and delays. These findings support Barkema *et al.* (1996, pp: 163) who state: "*The strong learning effect from earlier entries in the same country support the idea that 'experiential knowledge' (Johanson and Vahlne, 1977; Penrose 1959) from a country is relevant, and that it enhances the success of later expansions in the same country*".

### 5.3.3 Discrimination hazards

The efforts of foreign firms to obtain external credibility originate from discrimination treatment inflicted on the foreign firm relative to local firms in the host country (Eden and Miller, 2004). Such treatment can arise from differential treatment by governments, consumers, the general public and other firms. According to Kostova and Zaheer (1999), the lack of embeddedness of foreign firms in host countries relative to local firms could lead to discrimination treatment by host country stakeholders. Even when (national) laws advocate equal treatment, informal discrimination treatment could occur if foreign firms are perceived and treated as outsiders.

The interviews made clear several Dutch SMEs experience a preference of British firms to work with other British firms. This is mitigated by firm size; large foreign firms obtain contracts more easily than small foreign firms. The interviewed firms have various strategies to obtain external legitimacy in the UK in order to overcome discrimination hazards. For example **firm A**; prior to signing the contract for a project in the UK, this firm hired a well-known and highly regarded British engineering consultant to enlarge the credibility of its design. Subsequently firm A won the tender and signed a contract to design a major building in the UK. Now the firm is engaged in the design of this project, interviewee A states the firm's reputation has increased. He expects firm A to "win" future tenders in the UK more easily.

*“By designing this project we strengthen our reputation in the UK and we will definitely use it for PR-purposes in the future. We already reach the second round of tenders more often since the construction of this project started. We have a reputation now, and the project also ensures we can support claims we make with tangible evidence” (Interviewee A, June 2012).*

Therefore, by designing a large project which is well-known amongst potential clients, firm A has increased its external legitimacy in the UK.

**Firm D**, a bakery which produces savoury and sweet snacks, also utilized a strategy which includes cooperating with a British firm to obtain external legitimacy. Initially, firm A operated on the British market through a distributor as it wanted to take advantage from the distributor's network and reputation to launch products on the UK market. However, after some time firm D wanted more control over its operations in the UK as the distributor worked too soloist. Moreover, the firm was not able to enter agreements with large retailers through a distributor, which caused the growth of sales to stagnate. Subsequently firm D decided to participate in a partnership with a British firm to have more control and to benefit from the scale and reputation of this partner. After switching once of partner company, firm D currently works with a well-known and reputable partner. Firm D got to know this partner through contacts on various trade fairs. A major benefit of working with this partner is the fact this company enjoys good relationships with purchasing managers at major retailers. As a result, firm D currently has three of Britain's largest retailers amongst its clients. Hence by collaborating with a reputable British partner, firm D ensured it could enter into agreements with large clients in the UK.

**Firm I**, a publisher of business games, simulations and serious games, predominantly serves the British market through exports by a joint-venture in which it participates. Interviewee I states he does not experience any prejudices of the British towards firm I and for that reason does encounter discrimination hazards. He even indicates that cold calling - a marketing process of approaching potential clients who were not expecting such inquiries - is more effective in the UK than in the Netherlands. Nonetheless, with respect to the development and sales a new product, he states firm I is involved in a partnership with a major British publisher. Interviewee I states that by collaborating with this partner, firm I can benefit from both its scale and its relations with renowned authors. Since firm I's partner is a large firm that employs many account managers and has an extensive distribution network, firm I expects to increase sales more quickly through this partnership than when firm I would independently sell products to British clients. In addition, when a renowned British author associates his/her name to a product of firm I, this makes the product more appealing to clients than when only firm I's name is associated to it. Hence by making use of British reputations, firm I intends to increase the external credibility of its new product.

**Firm C**, which develops and produces ergonomic office chairs, started operations in the UK through a joint-venture with a former employee, which subsequently approached dealers. However, firm C ran into a similar sales limit with the use of dealerships as firm D with the use of a distributor. To overcome this stagnation, firm C decided to make an acquisition in the UK and subsequently the firm took over a British company. Hence firm C currently makes use of the reputation and network of this originally British firm. The same holds true for **firm F**, which also acquired a British firm. Interviewee F states firm F principally bought the customer base of the British firm concerned. Hence both firm C and firm F purchased existing business relationships in order to increase their turnover in the UK.

According to Glückler (2006), such deliberations are often the grounds on which firms base their decision to prefer acquisitions of foreign firms over greenfield subsidiaries.

**Firm H** entered the British market through an equity joint-venture with a British firm in order to benefit from this partner's market knowledge and network. Even though this partner withdrew itself from the joint-venture after three months, interviewee H states the network-relations of this partner have accelerated the pace of the start-up phase of the joint-venture. For example, firm H's partner knew which firms would be interested in the recycling services offered by the joint-venture. The personal contacts of firm H's partner at these potential clients ensured the joint-venture could sign contracts with them more easily. While firm H's partner withdrew itself from their joint-venture after just three months, interviewee H states by that time, firm H's involvement in British networks had reached a sufficient level for firm H to operate independently on the British market.

For **firm B** it was relatively easy to obtain external credibility in the UK as the firm's main client is the UK-division of a multinational with which firm B has worked with previously. Hence the firm was not perceived and treated as an outsider. Issues concerning external credibility in the UK do not affect **firm E**, as there are only three large developers and producers of sorting machinery for fruit and vegetables in the world, and none of them is British. Hence British customers of firm F have no other option than to buy foreign machinery. **Firm G** does not experience discrimination hazards as the firm mainly works for the British departments of existing clients which do not originate from the UK. In addition, interviewee G indicates firm G is not particularly interested in active acquisition of British clients and therefore does not face discrimination hazards.

Concluding, the efforts of internationalising firms to obtain external credibility originate from the fact they are "outsiders". That is to say, foreign firms have limited networks, lack a reputation and are not embedded in host countries. Various interviewed SMEs experience a preference of British firms to enter business agreements with other British firms. This inclines internationalising firms to enter the British market through contractual entry-modes in order to benefit from their British partner's embeddedness and reputation. In case of the interviewed SMEs which use equity entry-modes, they tend to prefer joint-ventures and acquisitions over greenfield investments, as this allows them to make use of existing business relationships. Moreover, this enables these firms to exploit established reputations. Accordingly, Schultz (2005) states acquisition strategies provide firms with the opportunity to take over the existing infrastructure and client networks of the acquired firm as well as the latter's reputation. The fact interviewee H states that after three months, the firm he represents was sufficiently involved in British networks to independently operate a subsidiary in the UK, suggests that building up networks and reputations abroad does not require long periods of time.

#### 5.3.4 Relational hazards

Relational hazards are related to the costs of organisation all firms face (Eden and Miller, 2004). According to Gaur and Lu (2007, pp: 88): "*relational hazards are associated with problems in managing relationships at a distance and include costs of monitoring, dispute settlement, opportunistic behaviour of local partners, and lack of trust in unknown partners*". Relational hazards can take the form of external organisation costs (external market transactions) or internal organisation costs (intrafirm transactions).

With respect to external market transactions, most interviewed firms consider British firms reliable. Only one firm has experienced opportunistic behaviour of clients. One of the causes for these generally positive experiences is the fact the interviewed firms predominantly collaborate with British firms which are recommended to them through their networks. According to Gulati (1999, pp: 400): *"firms enter into embedded ties with each other that are characterized by trust and rich information exchange across organizational boundaries"*. He continues with stating that networks of embedded ties are accumulated over time and can become the basis of a rich information exchange network that enables firms to learn about new alliance opportunities with reliable partners. As a result, firms may learn about each other because they have one or more alliance partners in common, who may have introduced them and perhaps has vouched for their reliability. This state of affairs is highlighted by interviewee A; he stated that the design manager hired by **firm A** not only advised on which firm would be a good engineering consultant, but also personally called a personal contact of him who is employed by the suggested firm, and asked whether that firm would be interested to participate in the project in which firm A is currently involved. **Firm H** is another example, firm H's main buyer of recycled plastics introduced the firm to the British firm with which it established a joint-venture in the United Kingdom. With respect to **firm I**, in the past this company had completed a project in the Netherlands in collaboration with the British firm which is currently its partner in the UK. Hence before these firms entered into an agreement to develop and sell a new product in the UK, they were already acquainted.

The absence of negative experiences with the trustworthiness of British firms can also be attributed to the use of contractual entry-modes. This strategy ensures potential end-clients of Dutch SMEs are screened by the local agents, distributors and partners which represent Dutch SMEs. The fact that these business partners of Dutch SMEs are also partly accountable for any problems (e.g. default of payments), gives them an incentive to carefully screen potential clients, and Dutch SMEs consequently face less relational hazards. According to Williamson (1985), relational hazards and related risk originate from difficulties in monitoring the contractual performance of exchange partners. Internationalising firms which start operations in unknown environments are therefore inclined to participate in partnerships in order to reduce risk (Lu and Beamish, 2001).

Various interviewees indicate British firms prefer to use contracts over agreements based on trust in order to organise economic transactions. This corresponds to the variations of capitalism literature which indicates that the UK is organised as a liberal market economy where firms rely on competitive markets to coordinate their endeavours (Hall and Gingerich, 2009). The following statement of interviewee F is illustrative of this state of affairs.

*"The British mindset is very much focused on contracts. In other countries we can work on the basis of trust and mutual agreement, but in the UK this is impossible. For firms with intentions to start operations on the British market it is therefore important to be informed about the British legal system. Perhaps the Dutch government could supply this legal knowledge"* (Interviewee F, November 2012).

The widespread use of contracts could also provide an explanation for absence of opportunistic behaviour of British firms experienced by Dutch SMEs. Here it is important to note, while security of contracts constitute powerful constraints on the behaviour of both the state and private agents, this result is only realized when they are consistently enforced (Haggard *et al.*, 2007).

The only firm with negative experiences with respect to the reliability of clients in the UK is **firm F**. As a result, interviewee F states that according to Western-European standards, he considers the UK unreliable. He gives an example from firm F's daily practice; in the industrial sector of firm F it is common practice for clients to pay five percent of contractually agreed prices a year after a project is completed, as a sort of warrantee. However, in almost all cases firm F has to be proactive, and incite British firms to pay the amounts due. According to interviewee F, those cases often result in endless discussions, because British firms try to avoid these payments. Consequently, this interviewee states that after reaching agreements with British individuals/firms, there is no guarantee whether agreed actions and policies are subsequently executed. This leads to his negative perception of the trustworthiness of British firms.

Only firms which operate internationally through equity entry-modes face internal organisation costs. The interviews make clear both **firm F** and **firm C** have experienced opportunistic behaviour of employees in the UK. With respect to the case of firm C, to overcome stagnating sales, firm C decided to make an acquisition in the UK and subsequently took over a British company specialised in lounge sofas and office chairs for lower segments of the market. At that time, this British firm had approximately 45 employees. From the start, firm C experienced difficulties originating from cultural differences between the UK and the Netherlands. According to interviewee C these differences mainly involved the managers of the subsidiary "*saying one thing but doing the another*".

*"Simply put, if British individuals do not agree with you, they do not mention it to you, yet they do not execute the agreements you think you have made with them. In Germany on the other hand, people mention their opinions and preferences, hence they make it possible to discuss problems and reach mutual understanding and consensus quickly" (Interviewee C, July 2012).*

Initially firm C handled these differences with understanding and politeness, but after a while the firm decided to manage its acquired subsidiary more strictly. Interviewee C states that in hindsight, firm C should have placed a Dutch operational manager at the head of the British subsidiary from the start. In light of this assertion, he continues with stating that firm C initially gave too much control to its subsidiary and should have managed the subsidiary more strictly from the start. **Firm F** did not experience broad difficulties in the management of its subsidiary in the UK. However, the firm did have an incident with an employee who, next to his work of firm F, also had his own business in underfloor heating and cooling systems. Obviously this state of affairs created a conflict of interest which firm F needed to solve. Even though firm F did not experience extensive management difficulties with its subsidiary in the UK, interviewee F states the subsidiary in the UK did require extensive management attention. This was one of the main reasons - amongst declining turnover and profits - for firm F to sell its subsidiary.

**Firm B** has no experiences of opportunistic behaviour of clients and employees in the UK. The firm currently employs two British freelance sales managers in the UK in order to expand sales. Hiring freelancers can be understood as a strategy to reduce intra-firm relational hazards to a minimum. At the time of the interview, firm B had utilized this strategy for a few months and until then, the firm did not experience any problems. **Firm H** also did not experience unreliable behaviour of British clients and employees. This firm minimises internal organisation costs by the appointment of a Dutchman in the management of its British subsidiary. Interviewee H indicates this Dutch manager is a son of firm H's plastics recycling manager in the Netherlands, and this state of affairs gives firm H's board trust in the management of its British subsidiary.



Concluding, generally Dutch SMEs perceive British firms as reliable and trustworthy. Especially firms which operate in the UK through contractual agreements share this opinion. This is caused by the fact that some SMEs make use of network-partners as agents, distributors and contractual partners in the UK. Moreover, the British partners of Dutch SMEs often select clients and for that reason screen them. Consequently the British partners of Dutch SMEs actually vouch for the reliability of clients (Gulati, 1999). Furthermore, in some cases the business relationship between Dutch SMEs and British agents and distributors is arranged in such a way that in case of defaults of payments, agents and distributors are partly accountable. As a result, these firm have an incentive to carefully screen clients. Consequently, Dutch SMEs can avoid incidents which are caused by unreliable behaviour of British firms, and might have extensive (financial) consequences.

With respect to intra-firm organisational costs, two out of four interviewed SMEs which operate in the UK through an equity entry-mode, have experienced opportunistic behaviour of British business partners. The firms concerned are Dutch SMEs that took over British firms, and experienced difficulties in managing the acquired subsidiaries. In literature it is acknowledged that high institutional distance makes subsidiary management more difficult as it increases information costs, hinders the transfer of management skills and produces inefficient principal-agent contracts (Barkema *et al.*, 1997). As a result, in these cases, problems in post-acquisition integration processes are also more likely to occur (Glückler, 2006). Large firms experienced with foreign acquisitions can draw knowledge from past experiences and apply it to better managing subsequent deals (Very and Schweiger, 2001). SMEs with limited international experience and intentions to internationalise to countries at high institutional distance are therefore more inclined to use shared control entry-modes (Erramilli and Rao, 1993).

## 5.4 The role of direct personal contact in internationalisation processes

Regardless of the entry-modes utilised by the researched firms, all interviewees state frequent direct personal contact is important during internationalisation processes. They particularly emphasise two reasons for this: first, certain matters can only be discussed through face-to-face meetings as information exchange is more easy through direct personal contact. This a property of direct personal contact which is also highlighted by Storper and Venables (2004). Second, the interviewees indicate sometimes they prefer to discuss matters face-to-face above e-mail or phone because "*then I can see who I am dealing with*". This perception is underlined by Storper and Venables (2004) who point out that trust- and commitment building is facilitated by direct personal contact. That is to say, face to face contact allows actors for the screening of other agents, and consequently contributes to the build-up of mutual trust.

### 5.4.1 Information exchange

**Firm A**, an architectural firm, has its office in the Netherlands and has stationed interviewee A in the UK. Interviewee A is present on the construction site to make decisions and answer questions with respect to design, that come up during the construction process. He states his physical presence in the UK is an advantage as his firm's clients and the (sub)contractors involved in the construction project in question prefer to talk face-to-face about issues which arise during the construction process.

*"For (sub)contractors it is mentally important to have a contact person who represents the architect on-site. Moreover, they favour to ask questions personally; I could answer most of their questions by e-mail, but they prefer to ask questions face-to-face" (Interviewee A, June 2012).*

According to interviewee A, as this procedure is such a satisfactory strategy for firm A, the firm intends to apply this procedure again for future, large projects that are situated abroad. According to Blomstermo *et al.* (2006, pp: 214): "*high control entry-modes may be preferred in order to build up personal relationships, conduct on-site research, and adapt to the needs of the foreign buyers and markets*". Hence by stationing an employee in the UK, firm A is able to exploit these benefits without the main disadvantage of high-control entry-modes: a requirement to make extensive resource commitments.

With regard to the relationship between information exchange and direct personal contact Wiedersheim-Paul *et al.* (1978, pp: 49) state: "*direct personal contacts are preferable when the exchange of information involves uncertainty or when it is rather impossible to foresee what will happen when the information transmitted creates new situations demanding new exchanges of information*". This characteristic of direct personal contacts is an important motive for firm A, an architect, to station an employee in the UK. A decision about a single aspect of a design of a building has consequences for the rest of the design, and subsequently for rest of the construction of the building. Hence, direct personal contact between architect and (sub)contractors is preferable over contact through, for example, email or telephone.

Wiedersheim-Paul *et al.* (1978) further explicate the relationship between product features and information flows between sellers and buyers. Here they emphasise the software/hardware relationship of a product because this conceptualisation stresses that a product is in fact a "package of services". The higher the hardware content - given the degree of technical complexity - the smaller the necessary information flow between seller and buyer. Products that include a more comprehensive package of software demand more extensive flows of information and more intensive contacts between seller and buyer. In this regard, the physical presence of a representative of firm A in the UK is meant to facilitate information exchange and to reduce coordination problems.

The same logic applies partly for **firm C**, which develops and produces ergonomic office chairs. To sell such a product, interviewee C states it is not only essential to have knowledge about the product, but also to have extensive knowledge about biomechanics and physiology, in order to be able to give a good and convincing sales talk. As employees of firm C possess such knowledge, firm C decided to start operations in the UK in 1999 via a joint-venture in which a former employee and firm C possessed shares. The former employee was appointed as managing director and controlled 30 percent of the shares while firm C controlled 70 percent of the shares. Initially only the former employee of firm C was employed, but later on two British sales managers were added to the sales team. This joint-venture signed dealers to sell the ergonomic office chairs on its behalf.

In order to be able to give a good and convincing sales talk, dealers had to be instructed on biomechanics and physiology. The required information flow is facilitated by direct personal contact with representatives of the joint-venture concerned. Later on growth flattened and firm C was not able to increase sales any more. To overcome this stagnation, firm C decided to make an acquisition in the UK and subsequently it took over a British firm specialised in lounge sofas and office chairs for lower segments of the market. Through this acquisition, and continued physical presence in the UK, firm C intended to enhance sales as the firm could not reach large clients via distributors.

The examples of firm A and firm C illustrate the facilitative role of direct personal contact in information exchange. Moreover, it indicates that the necessity of this type of contact may induce some internationalising firms to use particular entry-modes. As a result, firms that offer products which require a high degree of client and service-provider interaction often cannot engage in a regular export entry-mode but are constricted to the use of contractual and equity entry-modes (Cicic *et al.*, 1999). This observation suggests a relationship between the nature of the products and services that are offered by firms and the characteristics of their internationalisation processes (Erramilli and Rao, 1993). For instance, Roberts (1999) states business service firms generally start operations in foreign markets through exports, but sooner than manufacturing firms switch to high-control entry-modes, because sunk costs are lower for business service firms and because face-to-face contact is often necessary in the delivery, if not the production, of many business services. Hence the need for face-to-face contact in order to deliver services and transfer information can induce a firm to use high-control entry-modes. Especially if the institutional distance between countries is high, and communication therefore more difficult (Roberts, 2000; explained further in §5.4.4), firms can be inclined to use equity entry-modes in order to mitigate differences in cultural values and institutions (Tihanyi *et al.*, 2005).

#### 5.4.2 Commitment and trust

Next to facilitating information exchange, direct personal contact is important as it shows commitment and facilitates trust-building. The latter is partially the result of direct personal contact allowing firms to "screen" their (potential) business partners. This ensures business partners lose their anonymity. Accordingly, Storper and Venables (2004) state face-to-face contact not only reduces coordination problems, but also enables business partners to build mutual trust. Moreover, these authors state direct personal contact shows commitment (e.g. of time) to a partnership. Morgan and Hunt (1994) discern three reasons why commitment and trust are important in business relationships. First, these features push partners to work at preserving relationship investments by cooperating with exchange partners. Second, trust and commitment encourage partners to resist attractive alternatives in favour of the expected long-term benefits of staying with existing partners. Third, these features ensure partners will refrain from high-risk activities and will act prudent because of the belief that their partners will not act opportunistically.

Accordingly, frequent direct personal contact with business partners, clients and employees is an important element in the internationalisation strategies of all interviewed firms, as it helps to solve coordination problems and it contributes to build relationships characterized by trust and commitment. For instance, representatives of **firm B** visit clients in the UK every two to three weeks. The frequency of these visits was initially lower, but firm B's clients requested more regular face-to-face meetings. And while **firm C** has daily contact with its subsidiary by telephone and email, representatives of both offices meet face-to-face in the Netherlands or in the UK, approximately every two weeks. Finally, interviewee H, managing director of **firm H**, states he meets approximately 35-40 percent of the clients of firm H's British subsidiary at firm H's headquarter in the Netherlands. This procedure allows him to meet the representatives of major British clients, which jointly constitute 80 percent of the total volume of plastics recycled by firm H's subsidiary in the UK.

#### 5.4.3 Direct personal contact and liabilities of foreignness

The two qualities of direct personal contact discussed above - facilitation of information exchange and trust and commitment building - influence the liabilities of foreignness faced by internationalising firms. First, in physical proximity information is exchanged more easily as face-to-

face contact permits a depth and speed of feedback that is impossible in other forms of communication (Storper and Venables, 2004). This could mean that firms can reduce their unfamiliarity hazards, through the acquisition of market knowledge, more easily via direct personal contact in the UK. However, interviewees indicate they can obtain such information through other forms of communication than face-to-face contact. Market knowledge is relatively easy codified and is therefore communicable by e-mail or phone. Hence it can be argued that the exchange of information through direct personal contacts is not principally aimed at the attainment of market information, yet it is intended to reduce coordination problems which could result in relational hazards. Thus the use of direct personal contact to transfer information is mainly concerned with the reduction of relational hazards which take the form of internal and external organisation costs.

The second principal property of direct personal contact, facilitating the build-up of trust and commitment, is also important for the interviewed firms. Through direct personal contacts, foreign firms can screen potential business partners, causing them to lose their anonymity (Storper and Venables, 2004). The interviewed SMEs highly value this property of direct personal contact. For instance, although **firm D** operates in the UK through a partnership with a British firm, the firm intends to have direct personal contact with large, so-called end-clients from the UK. For this reason firm D invites these clients to the firm's factory in the Netherlands in order to get an understanding of (the request of) these clients and to lose its anonymity towards them. Hence direct personal contact can not only assist firms with the reduction relational hazards, it can also help them to limit discrimination hazards in order to obtain external credibility.

#### 5.4.4 Direct personal contact, institutions and learning processes

For business relationships to become successful, effective and appropriate communication is essential (Monczka *et al.*, 1995). When partners come from different cultures, it is more difficult to achieve good, reciprocal communication (Saatci, 2008). This is caused by institutional arrangements in terms of normative and cognitive contexts which influence the common practice by which direct personal contacts occur (Eden and Millar, 2004; Roberts, 2000). According to Ionascu *et al.* (2004), the higher the normative and cognitive distance between organizations, the more likely it is for cross-cultural communication to fail. These authors attribute this to differences in scripts, schemes, norms or values which impede information sharing between individuals from different cultures and might inhibit their ability to search for better alternatives. Next to cross-cultural communication is cross-cultural trust-building dependant on sharing a set of socially embedded values, cultural institutions, and expectations between actors (Roberts, 2000). Hence in order to be able to operate abroad, both employees and entrepreneurs have to transcend essential cultural dichotomies, to be able to operate in different institutional environments (Drori *et al.*, 2009). The embeddedness of individuals in both host and home societies denotes social behaviour which considers prospective action in two different institutional environments.

Although the institutional distance between the UK and the Netherlands is commonly perceived as relatively small, all interviewees indicate there certain cultural differences between the UK and the Netherlands. For instance, they state that the British tend to make extensive consultations and set up many meetings, find it hard to express criticism and are more "diplomatic" in their use of language. The following statement interviewee A made with respect to the British and their use of language illustrates this last assertion: "*hearing what they say is something else as understanding what they mean*". In this respect interviewee F states: "*Although you think you speak quite good English, you do not grasp the subtleties which are essential to understand the outcome of*

*a conversation*". Hence if an individual understands use language in the British culture, he/she does not necessarily understand the British people. For this reason individuals have to identify cultural and institutional differences and their underlying logics (Van Meeteren, 2011), in order to be able to operate in different institutional environments. The interviewees state such leaning processes occur through learning by doing. Interviewee A states for example that he read several books about 'doing business in the UK', before he came to the UK. While he considers this very useful, he states an individual can only get a true understanding of British culture by interacting with British people.

Interviewee I indicates that his previous international experiences - which do not concern the UK - are also useful in regard to his current activities in the UK. He states that the start of foreign operations by firms comes with pioneering and sorting out relevant issues which requires flexibility and the ability to operate in varying cultures. He has experience with these issues and he is therefore able to transcend cultural differences between the UK and the Netherlands relatively easy. In this regard, Reuber *et al.* (1997) have studied the relationship between internationalisation processes and the international experience of management teams of SMEs in the Canadian software industry. These authors find that firms with more internationally experienced management teams use more foreign strategic partners and delay less in obtaining foreign sales after start-up, which subsequently leads to a greater degree of internationalisation. They attribute this partially to the skills of internationally experienced management teams to identify and negotiate with firms in a different culture. Hence international experience in management teams can facilitate internationalisation processes as its members are better able to identify and transcend cultural dichotomies.

## 6. Conclusion and recommendations

The thesis is concerned with the following main research question: *What drives Dutch SMEs to start operations in the UK, and what is the foundation of the internationalisation strategies with respect to entry-modes which these firms use?* By researching literature and interviewing representatives of SMEs, a research effort is made to provide insight in the processes by which Dutch SMEs internationalise to the UK through equity and non-equity entry-modes. Based on the empirical findings of this thesis, this final chapter analyses the hypotheses formulated in chapter two, presents an answer to the main research question and provides a conclusion. Furthermore, recommendations for policy and some theoretical and managerial implications are presented in this chapter.

### 6.1 Analysis of the hypotheses

To answer this thesis' research questions, in chapter two theory was reviewed which resulted in the formulation of three hypotheses. Below these hypotheses are analysed with the empirical data collected from the in-depth interviews conducted for this thesis.

**Hypothesis 1:** Dutch SMEs internationalise to the UK since it is an institutionally close host country where these SMEs face limited liabilities of foreignness.

- The analysis of the interviews makes clear internationalisation processes are highly diverse, and the most pivotal distinction is whether they are unplanned and reactive or based on strategic decision-making processes. The unplanned nature that characterises of some internationalisation processes is mainly caused by the lack of resources experienced by SMEs (Crick and Spence, 2005). Many SMEs lack resources that are required to engage in planned internationalisation processes as these are accompanied with transaction costs. In these cases networks have an important role in explaining the choice for the UK as a host country because the SMEs concerned passively react to internationalisation requests. This finding confirms the network perspective of Coviello and Munro (1997), which explains that international market development activities emerge from, and are shaped by an external web of formal and informal relationships. For example firm G, this firm internationalised to the UK as a reaction to requests of clients which desired that firm G would offer its services in the UK. At a certain point, the number of these requests reached such proportions that firm G decided to comply, and subsequently this firm started operations in the UK.

SMEs which strategically assess foreign markets before internationalising also depend on network-partners to provide information. However, these SMEs generally cannot obtain full information about all possible alternatives because of information costs. As a result, firms often internationalise to countries about which they have superior knowledge (Erramilli, 1991). Mariotti and Piscitello (1995) reach a similar conclusion in their empirical study of foreign take-overs of Italian manufacturing firms. These authors find that acquisition decisions of foreign investors are chiefly governed by information costs.

As networks are characterised by trust and rich information flows (Gulati, 1999), it is relative easy for internationalising firms to obtain information about potential business partners and market characteristics through networks. Firms which internationalise in collaboration with network-partners are generally aware of each other's practices and desires, and therefore face limited discrimination and relational hazards. Networks can therefore facilitate internationalisation processes by reducing liabilities of foreignness.

To conclude, the institutional distance between the United Kingdom and the Netherlands is too high for Dutch SMEs to internationalise to the UK without network-partners, as these partners are necessary to reduce the liabilities of foreignness that Dutch SMEs face when they start operations in the UK. Thus this hypothesis is rejected because firms without network-contacts would find it difficult to internationalise to the UK.

**Hypothesis 2:** Dutch SMEs that internationalise to the UK are able to use equity modes to enter the British market as the UK is institutionally close to the Netherlands, which causes these SMEs to face limited liabilities of foreignness in this country.

- The analysis of the interviews made clear eight SMEs initially operated on the British market through non-equity entry-modes (particularly contractual entry-modes), and one interviewed firm started its UK operations through a joint-venture with a British partner. The choice for contractual entry-modes and joint-ventures is primarily motivated by the presence of unfamiliarity hazards and discrimination hazards. Dutch SMEs which internationalise to the UK generally need partners to inform them about British market characteristics. Moreover, Dutch SMEs experience a lack of embeddedness in foreign networks. This finding is in accordance with the network model of Johanson and Vahlne (1990), in which internationalising firms are originally active in a predominantly domestic network and through time develop relations in foreign nations. The analysis of the interviews revealed several Dutch SMEs experience discrimination hazards as entering British networks and obtaining British clients is sometimes exacerbated by the high embeddedness of local firms which increases the distinction between insiders and outsiders and therefore raises cognitive institutional distance (Eden and Miller, 2004). As a result, Dutch firms make use of reputations and networks of British firms and enter the British market through contractual entry-modes. An example is firm D which started operations in the UK with a distributor and currently operates in the UK through a partnership with a British firm. With respect to relational hazards, some SMEs which eventually switched to equity entry-modes experienced incidents of opportunistic behaviour. Especially post-merger integration processes of acquired British firms proved difficult. According to Barkema *et al.* (1997), subsidiary management is more difficult in cases of high institutional distance as it increases information costs, hinders the transfer of management skills and produces inefficient principal-agent contracts. Especially SMEs are vulnerable to management difficulties as they generally cannot draw knowledge from past experiences with subsidiary management (Very and Schweiger, 2001).

Regardless of the entry-modes utilised by the SMEs they represent, all interviewees highlight the importance of face-to-face contacts in internationalisation processes. Especially in case of products with high software components, which require intensive buyer-seller contacts to transfer information, it is preferable for the (selling) firm to have direct personal contact with foreign firms as face-to-face contact "*permits a depth and speed of feedback that is impossible in other forms of communication*" (Storper and Venables, 2004, pp: 354). This could even drive firms to use equity entry-modes to internationalise to countries which are institutionally distant in order to mitigate differences in cultural values and related institutions (Tihanyi *et al.*, 2005). Next to transferring information and solving coordination problems, direct personal contacts also facilitates the building of trust between two parties. This property of face-to-face contacts is of particular importance for Dutch SMEs that want to overcome discrimination hazards and limit relational hazards. Henceforth representatives of Dutch firms often visit clients/partners in the UK, or the other way round, to build

mutual trust. With respect to acquiring market knowledge, direct personal contacts proved less essential as such knowledge is easily codified and transferred by phone or mail.

It can therefore be concluded that the institutional distance between the Netherlands and the UK is relatively high and for that reason Dutch SMEs internationalising to the UK face liabilities of foreignness. This induces these firms to prefer non-equity entry-modes, especially contractual entry-modes, over equity entry-modes. The hypothesis is therefore not supported by empirical data.

**Hypothesis 3:** Dutch SMEs that internationalise to the UK engage in internal learning processes ('learning by doing') and external learning processes ('learning by interacting with partners') to obtain market knowledge and knowledge about both norms of stakeholders and local (business) culture.

- The analysis of the interviews made clear firms obtain market knowledge quite easily through interactions with partners or consultants. This finding is illustrated by the case of firm D, a producer of savoury and sweet snacks, which has a partnership with a firm from the UK to get informed about product requirements like maximum salt levels in snacks. External learning processes are also of importance in learning about norms of stakeholders. This finding is related to Gulati's (1999) notion of networks in which firms vouch for each other's reliability. For instance, firm H was introduced to its initial joint-venture partner in the UK by the chief buyer of recycled plastics from the Netherlands. Through 'learning by doing', the organisation and interpretation of partnerships and client-relations is refined. Hence predominantly external learning processes with members from their network, varying from agents, dealers, partners and clients, provide firms with information about both markets and relevant actors that are considered trustworthy.

Local (business) culture in the UK differs from the Netherlands'. Learning about British culture runs primarily through internal learning processes. These include issues like how to effectively organise partnerships with actors from the UK and the way to deal with clients. This requires individuals to identify cultural and institutional differences and their underlying logics (Van Meeteren, 2011), in order to be able to operate in the UK. Here direct personal contact with British individuals is important as individuals can only get a thorough understanding of a foreign culture by engaging in it. This hypothesis is therefore supported by empirical data.

## 6.2 Conclusion

The Dutch economy is amongst the most highly internationalised in the world. Amongst the most pivotal trade partners of the Netherlands is the United Kingdom (UK) which constitutes for 8.1 percent (€30 billion) of total Dutch goods exports in 2011 and ten percent (€9 billion) of total Dutch services exports in 2010. An important part of these exports is provided for by SMEs. The Netherlands British Chamber of Commerce estimates approximately 25,000 SMEs operate in the UK through non-equity entry modes like agents and distributors, and about 600 Dutch SMEs have a subsidiary in the UK. These SMEs have to deal with uncertainty and risk because they start operations in a country which institutional system differs from the Dutch institutional system. As a result, they experience liabilities of foreignness in the UK. These liabilities of foreignness consist of unfamiliarity hazards, discrimination hazards and relational hazards. Firms can limit their liabilities of foreignness by engaging in learning processes in order to sophisticate their routines with market knowledge and knowledge about norms of stakeholders and local (business) culture.



The nine interviews conducted in the empirical part of this thesis indicate that several SMEs operate on the British market as a result of unsolicited orders and other serendipitous events, and consequently did not strategically plan their internationalisation to the UK. Hence a general lack of resources, which results in limited planning capabilities, leads SMEs to exhibit opportunistic behaviour and react to opportunities as they present themselves (Crick and Spence, 2005; Gilmore *et al.*, 2001; Meyer and Skak, 2002). As a result, their choices for both a host country and a particular entry-mode are unplanned. When using the 'liabilities of foreignness perspective', these reactive strategies ensure SMEs do not have to engage in extensive learning processes and consequently avoid transaction costs. That is to say, in these cases internationalising SMEs do not have to search for potential partners/clients in the UK, because they present themselves. Hence in these cases firms do not have to overcome any discrimination hazards which might hinder a firm's internationalisation process. Generally, requests to start foreign activities originate from a firm's own network. In these cases internationalising SMEs do not have to deal with extensive relational hazards because firms that are included in networks are considered trustworthy as a result of positive experiences in the past. Firms which are related through networks consider each other trustworthy because when firms want to enter a network, they usually require another firm to vouch for their reliability before it can enter the network concerned (Gulati, 1999). Finally with respect to unfamiliarity hazards, firms actively soliciting SMEs to internationalise, often provide these SMEs with market knowledge like product requirements and relevant government delegations.

Hence to conclude, SMEs without extensive resources are able to internationalise to the UK when they react to unsolicited orders and other serendipitous events because, in these cases, they do not have to engage in extensive learning processes in order to limit their liabilities of foreignness, and therefore they are able to minimise transaction costs.

Obviously, these benefits of network-relationships are also profound for SMEs for which the involvement in international operations is the result of a strategic decision-making process. Also in these cases, network-partners can ensure that internationalising SMEs face less extensive liabilities of foreignness because they can provide market knowledge, introduce reliable clients/partners and allow internationalising SMEs to benefit from their reputation. Lu and Beamish (2001) state that prior research on the relationship between alliances/networks and internationalisation process also points to benefits like minimisation of transaction costs, increased market power, shared risks and better access to key resources such as capital and information. Hence external learning processes can provide firms with the knowledge that is required to reduce the transaction costs that accompany internationalisation processes. In these processes, "*internationalising SMEs need to depart from the existing routines and practices developed in their original markets and develop new knowledge about foreign markets and learn local practices*" (Lu and Beamish, 2001, pp: 22). Generally network-partners are responsible for the provision of such new knowledge about both markets and norms of stakeholders (Lee *et al.*, 2012), thereby ensuring that internationalising SMEs face limited liabilities of foreignness. Yet network-partners often cannot provide full information about all alternatives, subsequently driving SMEs to internationalise to markets about which they have superior information (Errimilli, 1991). Consequently, network-partners can be understood to guide foreign market selection and influence the pattern of market investment (Coviello and Munro, 1997).

The empirical part of this thesis indicates that the internationalisation strategies with respect to entry-modes of Dutch SMEs which internationalise to the UK, in several cases demonstrates a lack of

strategic planning. This finding is in accordance with Crick and Spence (2005), who state that both host country selection processes and entry-mode choices can result from serendipitous events. In these cases, the same line of reasoning that is applied for unplanned host country selection processes holds true. When Dutch SMEs are approached by (British) firms which want to act as agents/partners on their behalf, or which present export orders, Dutch SMEs can avoid initial discrimination and unfamiliarity hazards and consequently face limited transaction costs when they start operations on the British market.

With respect to firms which deliberately select particular entry-modes, all but one Dutch SMEs started operations in the UK started through a non-equity entry-mode. The use of local partnerships has several benefits for internationalising firms. As mentioned before, British partners - whether agents, dealers or contractual partners - can provide Dutch SMEs with market knowledge they generally lack. Moreover, through the use of collaborations with British firms, internationalising Dutch SMEs are able to make use of the networks and reputations of these firms, thereby allowing internationalising firms to overcome any discrimination hazards they might encounter. As the start of foreign operations of SMEs is often related to activities of network-partners which' trustworthiness is perceived positively (Gulati, 1999), internationalising SMEs face limited external relational hazards. Nonetheless, the interviews conducted in the empirical part of this thesis indicate that SMEs that operate in the UK through equity entry-modes face relatively extensive internal relational hazards.

These hazards principally originate from a lack of knowledge about local (business) culture in the UK. The interviews made clear that it is impossible to obtain information about this subject through external learning processes. Consequently, Roberts (2000) states cultural knowledge has a tacit character and is therefore relatively difficult to transfer. This is caused by institutional arrangements in terms of normative and cognitive contexts which influence the common practice by which direct personal contacts occur (Eden and Millar, 2004; Roberts, 2000). Through direct personal contact and learning by doing, individuals are able to learn about local (business) culture. Hence in order to be able to operate abroad, both employees and entrepreneurs have to transcend essential cultural dichotomies, to be able to operate in different institutional environments (Drori *et al.*, 2009). SMEs generally lack these capabilities and face resource constraints which limit their ability to engage in learning processes concerned with the acquisition of such capabilities. As a result, the management of a subsidiary in the UK proves to be relatively difficult for Dutch SMEs (Lu and Beamish, 2001).

The role of direct personal contact is not confined to facilitate learning processes concerned with obtaining knowledge about normative and cognitive contexts which comprise local (business) culture. In addition, direct personal contact facilitates the development of mutual trust which is important in business relationships between partners as it reduces (relational) uncertainty and encourages stability (Merino and Grandval, 2012). Hence relational hazards are reduced by frequent encounters between business partners.

To conclude, the institutional distance between the UK and the Netherlands compels internationalising Dutch SMEs to engage in external learning processes with network-partners in order to reduce their liability of foreignness. This state of affairs explains the essential role of networks in host country selection processes and the preference of internationalising Dutch SMEs to use non-equity entry-modes to enter the British market. The fact that Dutch SMEs which operate in

the UK through equity entry-modes face relatively extensive internal relational hazards also indicates that the institutional distance between the UK and the Netherlands is relatively high.

### **6.3 Theoretical implications and further research**

Some of the interviewed SMEs increased their commitment to the British market by switching from agents to contractual partnerships or by switching from non-equity to equity entry-modes. This finding provides support for the conceptualisation of Johanson and Vahlne (1977) in which firms gradually build-up commitment as they obtain local market knowledge. However, the results of this thesis indicate that next to gaining market knowledge, through time firms also get increasingly involved in foreign networks and learn about norms of stakeholders, thereby reducing discrimination and relational hazards. Hence the involvement of SMEs in international markets can be conceptualised as gradual learning process which is not solely concerned with the reduction of unfamiliarity hazards.

Therefore, with respect to further research and refinement of theoretical models, this thesis partly builds on the notion of Coviello and Munro (1997, pp: 379), who state that their study: *"has shown that we are better able to understand the internationalisation process of small firms by expanding our research focus to integrate the models of incremental internationalisation with the network perspective"*. This results of this thesis confirm that internationalisation processes of SMEs generally have an incremental character, and the essential role of networks is also backed up by this thesis' findings. That is to say, institutional differences between countries causes internationalising SMEs to face liabilities of foreignness, which are predominantly reduced through external learning processes with network-partners. Subsequently SMEs are able to increase their commitment to foreign markets.

However, in some cases, as commitment rises and subsidiaries are established, it proves relatively difficult for SMEs to manage subsidiaries as a result of differences in (business) culture. In order to get an understanding of customary behaviour in business relationships, individuals therefore need to engage in internal learning processes through learning by doing. Further research could provide the answer whether difficulties in the management of subsidiaries is confined to Dutch SMEs which operate in the UK, or if SMEs with subsidiaries in other countries experience similar difficulties. For that reason, the predominant subsidiary management practices of SMEs would also provide an appealing subject for further research. It would be interesting to study the success and failure of certain management practices, and the effects of institutional and environmental factors on the nature and success of management practices.

### **6.4 Managerial implications and policy recommendations**

This thesis provides some results which could prove valuable for managers of SMEs that pursue activities in foreign markets like the United Kingdom. Several interviewees explicitly indicate that expanding networks is their main recommendation for firms which intend to internationalise to the UK. This could be achieved through attending trade fairs, exhibitions and related events. Moreover, through participation in trade missions, SMEs can also get involved in foreign networks. Through network-contacts, firms can obtain knowledge about foreign markets, and they might even get 'pulled abroad', when they are requested by another organisation to start operations in a foreign country. In this light, SMEs can also try to get involved in business relationships with Dutch subsidiaries of multinationals. These subsidiaries could give good credentials on the SMEs concerned, which subsequently might be requested to get involved in business relationships with

subsidiaries in other countries. In this way, internationalising SMEs would face less extensive liabilities of foreignness.

With respect to entry-modes, it would be recommendable for SMEs to start activities in the UK through contractual entry-modes because the institutional distance between the UK and the Netherlands turns out to be relatively high. For that reason, Dutch SMEs face liabilities of foreignness in the UK. Through partnerships with British firms it is possible for Dutch firms to overcome initial unfamiliarity hazards and discrimination hazards. A perfect scenario would be if the British firms concerned are involved networks in which Dutch SMEs also participate. In this way, Dutch SMEs would experience increased certainty about the trustworthiness of potential partners, and would therefore face less extensive relational hazards. For example, firm I is involved in a partnership with a British firm to develop and sell a new educational product in the UK. As firm I and the British firm concerned had collaborated satisfactorily on a project in the past, both firms face limited relational hazards with respect to their current partnership. However, as relational hazards cannot be entirely reduced, interviewee D states the firm he represents and its contractual partner have defined an exit-strategy in the event one of both firms considers the collaboration unsatisfactory. He recommends this strategy to other internationalising SMEs.

For various reasons, several SMEs prefer to start in the UK through equity entry-modes. These reasons would include cases in which a physical presence is required in order to deliver services correctly. Moreover, firms with highly specific assets are more inclined to engage in an equity entry-mode to make sure it has more control over the (mis)use of its assets. In these cases it would be recommendable to appoint managers/directors who are accustomed to both British and Dutch (business) culture in order to avoid intra-firm relational hazards which might originate from cultural differences. Moreover, SMEs inexperienced with internationalisation processes are recommended to engage in incremental internationalisation processes by starting a joint-venture with a local partner. In this way, these firms can learn about local (business) culture without being exposed to excessive risk with respect to relational hazards.

When the results of this thesis are placed in a policy context, several suggestions to further refine policy become apparent. With respect to economic departments of embassies, NBSOs and related organisations, the results of this thesis indicate that sustaining extensive networks would be one of their main tasks. For instance, interviewee E states local Dutch agricultural councils assisted the internationalisation of the firm he represents to the Middle East and the Far East. The counsel's staff personally introduced firm E to the most important players on the local agricultural market. Furthermore, government organisations like embassies and NBSOs could publicize upcoming trade fairs, exhibitions and related events in foreign markets of particular interest. In this way, firms that are interested in starting activities in these countries can be notified about such events. Obviously, other organisations like trade associations could also provide this information. In the same line of reasoning, interviewee E suggests governments could sponsor exhibition stands or organise shared stands in which several (related) SMEs participate and present themselves. This could enable firms to overcome resource constraints. Another way to increase the involvement of Dutch SMEs in foreign networks would be to organise trade missions. Through trade missions internationalising firms are able to identify potential foreign business partners.

In order to reduce unfamiliarity hazards, firms must have knowledge about foreign markets like particular product requirements. The main sources of this knowledge for internationalising Dutch SMEs turn out to be British partners like agents, distributors and contractual partners. Hence

governmental agencies should not be primarily responsible for the provision of in-depth knowledge about foreign market characteristics. However, interviewee F states governmental agencies could offer information about the British legal system in order to inform SMEs about the best way to reduce relational hazards. As a result, Dutch SMEs can get aware of contractual risks and are enabled to draw up contracts which maximally limit relational risk and exposure to unreliable behaviour. It would therefore be recommendable for government agencies to provide legal knowledge to internationalising firms.

Finally, the progress of this research was hampered by a lack of specific data about which Dutch firms actually operate on the British market. Both for further research and public policy, it would be recommendable to get a clearer view on the features of these firms. Especially databases with firms which use equity entry-modes and non-equity entry-modes to operate in the UK, would be valuable for additional research which subsequently could further inform public policy.

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## Appendix 1: Chi-square tests

	Non-equity entry-modes	Equity entry-modes	Totaal
Size: small (0-100 employees) N	60	8	68
%	83.3%	44.4%	75.6%
Size: medium (>100 employees) N	12	10	22
%	16.7%	55.6%	24.4%
Totaal N	72	18	90
%	100%	100%	100%

Chi=11,79 Cramer's V=0,36

	Non-equity entry-modes	Equity entry-modes	Totaal
Sector: manufacturing N	29	7	36
%	40.3%	38.9%	40.0%
Sector: services N	43	11	54
%	59.7%	61.1%	60.0%
Totaal N	72	18	90
%	100%	100%	100%

Chi=0,01 Cramer's V=0,01

	Non-equity entry-modes	Equity entry-modes	Totaal
Age: medium N	28	5	33
%	38.9%	27.8%	36.7%
Age: old N	44	13	57
%	61.1%	72.2%	63.3%
Totaal N	72	18	90
%	100%	100%	100%

Chi=0,77 Cramer's V=0,09

Critical values of the chi-square distribution (Field, 2009)

	p	
Df	0.05	0.01
1	3.84	6.63
2	5.99	9.21
3	7.81	11.34

## Appendix 2: Questionnaire

### Kenmerken bedrijf

1. Wat is uw functie?
2. Wanneer is uw bedrijf opgericht?
3. Hoeveel werknemers heeft het bedrijf?
4. Hoe zou u de activiteiten van het bedrijf omschrijven?
5. Sinds wanneer is het bedrijf internationaal actief, in welke landen en onder welke organisatorische vorm?  
Indirecte export, agent, distributeur, directe export, licentie, joint-venture, dochteronderneming

### Achtergrond bij de keuze voor de UK en de entry-mode

6. Hoe worden buitenlandse markten waarin het bedrijf actief wordt gekozen?  
**Externe partijen:** Overheid (Nederlands en Verenigd Koninkrijk), klanten, samenwerkingspartners, toeleveranciers, familie en vrienden, branchevereniging, KvK, andere ondernemers, professioneel adviesbureau.
  - Wordt hierbij overleg gepleegd met andere partijen?
  - Wordt een intrede op toekomstige buitenlandse markten gepland of speelt het bedrijf in op kansen die zich voordoen?
7. Indien het bedrijf al internationaal actief was voordat u actief werd in het Verenigd Koninkrijk, was deze ervaring van toegevoegde waarde tijdens het starten van activiteiten in het Verenigd Koninkrijk?
8. Wat was de motivatie om specifiek in het Verenigd Koninkrijk actief te worden?  
**Externe partijen:** Overheid (Nederlands en Verenigd Koninkrijk), klanten, samenwerkingspartners, toeleveranciers, familie en vrienden, branchevereniging, KvK, andere ondernemers, professioneel adviesbureau.
  - Had u al contacten met externe partijen in dit land voordat u internationaliseerde?
  - Was u voorheen actief op markten die vergelijkbaar zijn met het VK?
  - Waren er mensen in uw organisatie die Engels spraken? Was dit een overweging?
9. Hoe is het sluiten van het eerste contract van het bedrijf in het Verenigd Koninkrijk verlopen?  
**Externe partijen:** Overheid (Nederlands en Verenigd Koninkrijk), klanten, samenwerkingspartners, toeleveranciers, familie en vrienden, branchevereniging, KvK, andere ondernemers, professioneel adviesbureau.
  - Hoe heeft het bedrijf een zakenpartner gevonden?
  - Van wie kwam het initiatief om zaken te doen?

- Indien van het andere bedrijf, hoe heeft dit bedrijf uw bedrijf leren kennen?
10. Onder welke organisatorische vorm ben u actief geworden in het Verenigd Koninkrijk?  
Indirecte export, agent, distributeur, directe export, licentie, joint-venture, dochteronderneming
- Zijn er specifieke redenen waarom u actief bent geworden onder deze organisatorische vorm?
  - Bent u nog steeds actief onder deze organisatorische vorm? Waarom wel/niet?
  - Terugkijkend, zou u wederom gebruik maken van deze organisatorische vorm als u internationaliseerde?
  - Heeft u plannen om in de toekomst van organisatorische vorm te veranderen? Waarom wel/niet?
11. Indien Joint Venture: Hoe is het sluiten van het contract met het Britse bedrijf verlopen?  
**Externe partijen:** Overheid (Nederlands en Verenigd Koninkrijk), klanten, samenwerkingspartners, toeleveranciers, familie en vrienden, branchevereniging, KvK, andere ondernemers, professioneel adviesbureau.
- Hoe heeft het bedrijf een zakenpartner gevonden?
  - Van wie kwam het initiatief om zaken te doen?
  - Indien van het andere bedrijf, hoe heeft dit bedrijf uw bedrijf gevonden?
12. Indien equity entry-mode: Is het management van de Britse vestiging even makkelijk als het management van Nederlandse nevenvestigingen?
- Zo nee, wat verschilt er en wat voor moeilijkheden levert dit op?
  - Hebben er Nederlanders in het management van de subsidiary plaatsgenomen?
  - Hoe vaak is er contact met het management van de vestiging in het Verenigd Koninkrijk?
  - Hoe is dit contact georganiseerd (bezoek, telefonische updates, email etc.)?
  - Heeft het hoofdkantoor in Nederland ook contact met Britse klanten van de nevenvestiging?
  - Hoe monitort het bedrijf de prestaties van de nevenvestiging?
13. Had u vooraf gedacht tegen vertragingen/problemen aan te lopen tijdens de internationalisering van uw bedrijf? Was dit van invloed op uw keuze voor het Verenigd Koninkrijk als buitenlandse markt?
14. Bent u tegen vertragingen/problemen aan gelopen tijdens uw internationalising naar het Verenigd Koninkrijk? Hoe heeft u deze opgelost? Heeft u hierbij hulp gehad van een andere partij? Zo ja, welke partij?

### **Internationaliseringsproces**

15. Hoe bent u aan kennis/informatie over wet- en regelgeving in het Verenigd Koninkrijk gekomen?
- Externe partijen:** Overheid (Nederlands en Verenigd Koninkrijk), klanten, samenwerkingspartners, toeleveranciers, familie en vrienden, branchevereniging, KvK, andere ondernemers, professioneel adviesbureau.



- Wat is de invloed van wet- en regelgeving op de activiteiten van uw bedrijf?
- Was het eenvoudig om te voldoen aan deze wet- en regelgeving?
- Hoe en wanneer heeft u deze kennis verkregen?
- Zijn externe partijen nuttig bij het verkrijgen van informatie over wet- en regelgeving?  
Zo ja, welke en waar zijn deze gevestigd?

16. Gedragen bedrijven, organisaties en consumenten in het Verenigd Koninkrijk zich volgens vergelijkbare normen als in Nederland? (Normen: hetgeen geaccepteerd wordt als de **juiste** manier om een doel te bereiken)

**Belangrijke thema's:** Betrouwbaarheid, het gebruik van contracten, vertrouwen, corruptie en eventuele vooroordelen naar buitenlandse bedrijven toe

**Externe partijen:** Overheid (Nederlands en Verenigd Koninkrijk), klanten, samenwerkingspartners, toeleveranciers, familie en vrienden, branchevereniging, KvK, andere ondernemers, professioneel adviesbureau.

- Zo nee, wat zijn de verschillen en hoe beïnvloeden deze de activiteiten van uw bedrijf?
- Hoe en wanneer bent u op de hoogte gekomen van eventuele verschillen?
- Was het eenvoudig om u aan te passen aan de eventuele verschillen?
- Zijn externe partijen nuttig bij het verkrijgen van informatie over eventuele verschillen?  
Zo ja, welke en waar zijn deze gevestigd?

17. Is de zakelijke cultuur in het Verenigd Koninkrijk vergelijkbaar met de zakelijk cultuur in Nederland?

**Belangrijke thema's:** Gebruiken/rituelen, vaardigheden en stijl/manier van zaken doen.

**Externe partijen:** Overheid (Nederlands en Verenigd Koninkrijk), klanten, samenwerkingspartners, toeleveranciers, familie en vrienden, branchevereniging, KvK, andere ondernemers, professioneel adviesbureau.

- Zo nee, wat zijn de verschillen en hoe beïnvloeden deze de activiteiten van uw bedrijf?
- Hoe en wanneer bent u op de hoogte gekomen van eventuele verschillen?
- Was het eenvoudig om u aan te passen aan de eventuele verschillen?
- Zijn externe partijen nuttig bij het verkrijgen van informatie over eventuele verschillen?  
Zo ja, welke en waar zijn deze gevestigd?

18. Vind u even makkelijk klanten/partners in het Verenigd Koninkrijk als in Nederland?

**Externe partijen:** Overheid (Nederlands en Verenigd Koninkrijk), klanten, samenwerkingspartners, toeleveranciers, familie en vrienden, branchevereniging, KvK, andere ondernemers, professioneel adviesbureau.

- Zo nee, waarom niet en hoe beïnvloed dit de activiteiten van uw bedrijf?
- Hoe en wanneer bent u op de hoogte gekomen van eventuele verschillen?
- Was het eenvoudig om u aan te passen aan de eventuele verschillen?
- Zijn externe partijen nuttig bij het verkrijgen van informatie over eventuele verschillen?  
Zo ja, welke en waar zijn deze gevestigd?

19. Is het even makkelijk om op de hoogte te komen van de wensen van klanten in het Verenigd Koninkrijk als in Nederland?

**Externe partijen:** Overheid (Nederlands en Verenigd Koninkrijk), klanten, samenwerkingspartners, toeleveranciers, familie en vrienden, branchevereniging, KvK, andere ondernemers, professioneel adviesbureau.

- Zo nee, waarom niet en hoe beïnvloedt dit de activiteiten van uw bedrijf?
- Hoe en wanneer bent u op de hoogte gekomen van eventuele verschillen?
- Was het eenvoudig om u aan te passen aan de eventuele verschillen?
- Zijn externe partijen nuttig bij het verkrijgen van informatie over eventuele verschillen? Zoja, welke en waar zijn deze gevestigd?

20. Hoe managet het bedrijf zijn activiteiten in het Verenigd Koninkrijk?

- Is er regelmatig contact met zakenpartners in het Verenigd Koninkrijk?
- Heeft het bedrijf vaste contactpersonen?
- Hoe is dit contact georganiseerd (bezoek, telefonische updates, email etc.)?
- Hoe monitort u de prestaties van uw zakenpartners?

### **Netwerken**

21. Wat is de rol van beurzen en andere evenementen bij de internationalisering van uw bedrijf?

- Ging er vaak een afgevaardigde van uw bedrijf naar dergelijke evenementen?
- Wat leverde dergelijke evenementen op voor de internationalisering van uw bedrijf?

22. Is het opdoen van contacten en het uitbreiden van uw netwerk in het Verenigd Koninkrijk van groot belang voor de internationalisering van uw bedrijf? Waarom wel/niet?

### **Aanbevelingen**

23. Wat zou u bedrijven die actief willen worden in het Verenigd Koninkrijk willen aanraden?

24. Wat zou de Nederlandse overheid kunnen doen om de internationalisering van bedrijven naar het VK te vergemakkelijken?