The Mercadex-Desjardins model
A heuristic approach to planning internationalization strategies for SMEs

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Summary

The framework suggested in this article allows the SME's manager to apprehend various internationalization options with respect to expanding activities in foreign countries. Thus, the selection of a successful internationalization strategy would be based on two specific axes: the level of integration and the means of penetration of the firm in the foreign market. The first axis assists the manager in defining the extent to which the company could (should) commit to the host country in terms of integration (delegation, cooperation, control), while the other axis helps determine the means of penetration into that country (transactional, contractual, control). The planning/revisiting process of a successful internationalization strategy takes into account the combination of these two decision axes, which, in turn, are made up of integration and penetration variables.

Introduction

The aim of the research project led by Mercadex International in cooperation with Quebec's Caisse centrale Desjardins was to examine the decision-making process of managers of small or medium-sized enterprises (SMEs), given the wide range of internationalization strategy options available to them (e.g. direct or indirect exports, imports, agreements, joint ventures, foreign direct investments), and to develop a tool to assist managers of SMEs with the formulation and validation of internationalization strategies.

Over the past forty years, the research approaches of various researchers (e.g. Hymer, Kindleberger, Dunning, Vernon, Chandler, Omhae) have generally focused on the study of the internationalization process of transnational firms or large-scale companies. Despite efforts and progress made by SMEs on the international scene in the past few years, they still seem to be overlooked in favour of large companies when it comes to studying their internationalization processes. Moreover, experts often attempt to explain the expansion of SMEs into foreign countries using models designed first and foremost for large-scale companies. In order to illustrate this phenomenon, Nkongolo-Bakenda and D'Amboise (1996) noted that several models designed for large companies have been adapted to SMEs, with more or less favourable results, in order to explain or suggest a strategic approach to internationalization. Classic approaches, like the model according to which the internationalization of a company is linked to the theory of a product's life cycle (Vernon, 1996), no longer reflect the reality of SMEs expanding into foreign markets. It is nevertheless comforting to observe that, in the past decade, an increasing number of researchers (e.g. Joyal, Julien, Léo, Christensen, Morin, Zhan, Poisson) have become interested in the internationalization of activities of SMEs, given their growing presence abroad that has been facilitated by an ever-increasing use of information technologies and greater economic integration.

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Methodology

The study comprised three research components. The first, which was empirical in nature, consisted in using a certain number of internationalization case studies of SMEs drawn from a pool of Mercadex clients. This made it possible to develop an initial model on which the two other research components were based. A literature review that focused on the internationalization of the SMEs was done as part of the second component, examining these companies in greater detail. The third and final component consisted in a series of in-depth guided interviews of some twenty SMEs throughout Quebec. The choice of companies was based on criteria that included having been active or present on the international scene (outside of the United States) for at least five years and posting sales figures of the order of C$10 million or more. The remaining sample of companies that participated in the study and their respective international strategies were quite varied, ranging from service companies, software designers carrying out import and export activities, sales of licenses or franchises, foreign direct investments and strategic alliances with or without capital.

Main observations of the study

If we compare their trade with that of multinational firms, in terms of both volume and value, SMEs continue to occupy a marginal position on the international scene. In addition, most SMEs are primarily concerned with domestic markets. For managers of these businesses, crossing the border means straying from the beaten path, which means increased risk and greater investment. Not all SMEs are interested in internationalization. Managers of these types of businesses must, however, plan for sustainable business growth in a market that is becoming increasingly international.

SMEs undergoing international expansion are exposed to challenges, opportunities, restrictions and risks that cannot be compared with those confronted by large companies. The results of the study have made it possible to highlight a certain number of unique features that distinguish SMEs from large firms.

Relativizing the importance of a competitive advantage in foreign markets

Most of the companies interviewed were unable to immediately recognize the relevance of transferring their competitive advantage to the desired foreign market. In fact, as long as the value of foreign competition remains unrecognized, the term “advantage” cannot be used. It might be more appropriate to refer to distinctive forces or hypothetical competitive advantages (that have yet to be verified). It is possible for a company to relativize or determine its actual competitive advantages or disadvantages by measuring itself against rival companies. It is easier for large-scale companies with the necessary resources and access to an abundance of information (often public) about its rivals (e.g. annual reports, financial analysis reports, press reviews) to measure and identify the competitive advantages or disadvantages than it is for SMEs (especially family businesses). In any case, SMEs have certain advantages over large firms (Karagozogin and Lindell, 1998), particularly in terms of flexibility and the ability to act quickly. On the international scene, however, the comparison is even more complex for SMEs whose competition resides in foreign markets.

The concepts of productivity and competitiveness

The study also illustrated that it is rare for the competitiveness of SMEs to rely on the concept of productivity or economies of scale. Most SMEs in the manufacturing industry generally produce short runs, subcontract their production operations and often manufacture customized products. It is nevertheless interesting to observe that companies doing business internationally demonstrate greater productivity than sedentary companies. Aside from productivity, the level of competitiveness of SMEs in foreign markets depends on other elements discussed previously (e.g. flexibility, ability to act quickly).

Management instinct

Since few SMEs have the internal resources needed to carry out intensive research activities (Julien, Beaudoin and Ndjambou, 1999), it is important for managers to have strong intuitive skills when it comes to making decisions and developing strategies. This type of instinct, however, quickly loses its effectiveness when applied to foreign markets. The relevance of managers' instincts is called into question in a foreign country as a result of differences in culture, game rules and business practices. SMEs that experience cross-border success constantly strive to increase their knowledge of new markets and do not hesitate to reformulate their hypotheses and question their intuition, even though it may be extremely useful in a domestic market.

The importance of information

For most SMEs trying to penetrate new markets, failure is not an option. Moreover, the internationalization process must be carefully planned, since opportunities to catch up are rare. According to some of the SMEs interviewed, internationalization efforts that are not based on sound investment can also lead to catastrophe. A sufficient and prior knowledge of openings, risks and conditions for success with regard to foreign markets is necessary despite very limited resources available to SMEs. Terpstra (1993) and Johanson and Vahlne (1977) recognized that, in international marketing, the high degree of uncertainty related to business expansion in new markets intensified the need to have market information available. It is also interesting to observe that a study recently conducted by Hart and Tzokas (1999) confirmed this observation, stating that "companies that gather the most information on export markets tend to significantly outperform the competition, as expressed by the ratio of export sales to overall company sales or the ratio of export profits to overall company profits." The study revealed that a targeted and structured search for business information is far superior to an improvised approach, making it possible for SMEs to improve their internationalization process and, consequently, their chances for success.

Uppsala school revisited

According to the theory of internationalization through learning (Uppsala school), a company gradually increases its presence in foreign markets, developing increasingly sophisticated strategies, by acquiring knowledge and gaining experience on the international scene (Poisson and Zhan, 1996). It is a mechanical approach that ranges from simple export activities (often occasional) to more elaborate internationalization strategies (e.g. licensing agreements, joint ventures, foreign direct investment). This line of thinking is less and less a reflection of current reality, especially as far as SMEs are concerned. Root (1994) specifies that, although presented as a sequence of activities and decisions, the strategic formulation is in fact continually being reexamined and is constantly changing.

The internationalization process of SMEs is therefore not linear and can even be reversible (e.g. strategic downturn). An exhaustive literature review by Poisson and Zhan (1996) called into question the generalization of the step-wise approach. Similarly, several of the SMEs interviewed as part of the study revealed that advanced internationalization strategies (licensing agreements, strategic alliances, technological transfers, investments) had been implemented at the outset of the internationalization process. The case of high-tech businesses proved to be especially revealing, since internationalization manifested itself mostly through the development of strategic alliances. A series of factors, such as the decreased life cycle of products (requiring wide-ranging and accelerated distribution), the growth of information technologies and the expansion of trade in international services, contributed to this phenomenon.

The Mercadex-Desjardins model: definition and application

An internationalization strategy must be defined for each new product-market couple (Root, 1994). It is dangerous to assume that the same approach can be applied regardless of the product (service) or foreign target market. According to Root (see Figure 1 in Appendix I), creating an international strategy requires the following five elements: 1- the choice of the product-market couple; 2- the aims and objectives associated with the target market; 3- the choice of strategy for penetrating the target market; 4- the marketing plan; and 5- the target market watch system.

The model discussed in this article was designed to enable managers of SMEs to address the third element of this process, which focuses on defining the company's internationalization strategy. According to the results of the study, creating such a strategy involves taking into account a multitude of variables and questions (answers) associated with the firm, the market (supply and demand) and the business environment in the foreign country. The study revealed the usefulness of considering the above-mentioned variables from the following perspectives: 1- the degree of integration and 2- the means used by the company to penetrate the host market (country).

Of the variables used to analyze and plan the strategy adopted by the company on the international scene, one type would make it possible to define the extent to which the company could commit to the host country in terms of integration, while another type would help determine the means of penetration into that country. The planning of a successful internationalization strategy takes into account these two decision axes, which, in turn, are made up of integration and penetration variables.

One of the companies that participated in the study will serve as an illustration. The company in question opted for increased integration into the foreign market since it had an excellent knowledge of the market, and was familiar with the target country's business practices and language. The company also based its decision on its previous history in international business, the desired control of trade channels, a complex product and a favourable perception of foreign firms in the host country. Moreover, the company had developed a contractual approach (e.g. licensing agreement, franchise, consortium) and a structural approach (e.g. joint venture, acquisition, foreign direct investment) rather than a transactional approach (direct or indirect export) as a result of the following variables: decreased production capacity, high customs duties, considerable freight transportation costs, adequate protection of property rights in the host country, tax incentives for foreign direct investment, regulatory control and legislation favouring the creation of alliances.

The Mercadex-Desjardins model proposes three levels of integration into foreign countries for SMEs: delegation, cooperation and control. The means of approaching the foreign country can be further divided into three elements, that is, the company can adopt a transactional, contractual or structural approach. The superposition of the two axes (three levels of integration and three means of penetration) results in a matrix containing nine generic internationalization options (strategies) for SMEs. Figure 2 in Appendix I illustrates these options, as well as the main elements of the model in question. The company's level of integration (involvement in the foreign market) is colour coded: red for "delegation," yellow for "cooperation" and green for "control." Also, the mode of entry is represented by geometric figures: a circle for a "transactional approach," a square for a "contractual approach" and a triangle for a "structural approach." A yellow triangle, for example, corresponds to a structural-cooperation strategy (e.g. joint venture), while a red square represents a contract-delegation strategy (e.g. licensing agreement). According to the model, a strategic (horizontal) move to the right implies an extension of the time line for the company's business project (or dealings), while a (vertical) move in a downward direction indicates the company's increased involvement (presence) in the host country.

The following table illustrates a few examples of internationalization strategies resulting from the nine generic strategies of the model being examined. The main characteristics of the model's two decision axes (level of integration and means of penetration) will be discussed in greater detail in the following pages.

Table 1
Examples of internationalization options resulting from the generic strategies of the Mercadex-Desjardins model

Means of penetration	*Transactional approach*	*Contractual approach*	*Structural approach*
Level of integration			
Delegation	▪ Outside trading house ▪ Subcontracting for a domestic exporting contractor	▪ Transfer of manufacturing license or ▪ Marketing license	▪ Minority participation in a foreign company
Cooperation	▪ Distributor in the target country ▪ Manufacturing agent ▪ Wholesaler	▪ Cross licensing ▪ Franchise ▪ Consortium	▪ Joint venture ▪ Reciprocal participation
Control	▪ Direct sale to a foreign client ▪ Sales office in the target country	▪ OEM ▪ Manufacturing agreement ▪ BOT	▪ Acquisition ▪ Foreign direct investment ▪ Greenfield

Decisions regarding the level of integration

The following will serve to illustrate the meaning of the various levels of integration into a foreign market (country). The president of an SME located in Écully (a suburb of Lyons) has business dealings with a client in Belo Horizonte, Brazil. During an upcoming business trip to Brazil, the president will have to consider hiring a driver if he is unable to speak Portuguese and is unfamiliar with the city (delegation). If, however, the president speaks fluent Portuguese, but is unfamiliar with the city, he may choose to hire a copilot (cooperation). Finally, if the president speaks fluent Portuguese and feels at ease travelling around the streets of Belo Horizonte, he can drive his own car without assistance from anyone (control).

Delegation

A company's first experiences on the international scene often involve a domestic business partner (e.g. contractor, outside trading house), who will act a product purchaser and carry out export activities. The company may not be aware of the final destination of the products, especially in the case of industrial components. This approach enables SMEs to begin the internationalization process slowly but surely and to get an initial idea of the foreign market potential for its products.

Cooperation

A company that is thinking about starting foreign business dealings should seriously consider enlisting the cooperation of partners. Strategic partners (Ohmae, 1989) are particularly important in foreign countries where the entry requirements are often greater than the company's resources. According to the cooperation approach, the company is relatively familiar with the foreign market (e.g. supply, demand, language, business culture), but does not have an established network of business contacts needed to successfully market its products in that country. Although after-sales service is important, technical assistance by the manufacturer may not be absolutely necessary. The manufacturer must, however, have a minimum of control over the product (and the distribution networks). Finally, the cooperation of a partner at the final destination is recommended when developing and implementing a marketing strategy.

Control

SMEs often adopt this approach in order to maintain a greater level of control over their product (e.g. in the case of a complex product) and distribution networks (e.g. sales force and intermediation margins). It may happen that clients insist on shorter channels (limited number of intermediaries), requiring an SME to get closer to the foreign market. In order to have "control," the company must have an excellent knowledge of the foreign country, its business practices and the language (if applicable). A favourable perception of foreign companies is another of the requisite conditions.

Decisions regarding the means of penetration

In order to examine decisions regarding means of penetration into a foreign country, consider the example of the company executive travelling to Belo Horizonte on business. Depending on the nature of the project and the number of trips planned, the company president must decide on his use of a car for travelling around the city. According to the Mercadex-Desjardins model, a transactional approach would be comparable to a daily car rental (on a regular basis) from a car rental service (in Belo Horizonte). Every time the president was in Brazil, he would rent a car for the duration of his stay. In the case of a contractual approach, the president would enter into a car lease agreement, at the end of which (after three years, for example) the lessee (in this case, the company president) would have the option to buy the car (by paying any outstanding balance) or return it to its owner (the financial institution, the manufacturer or the car dealer). In the case of a structural approach, the president would choose to purchase the vehicle, that is, to invest the required sum of money in order to have title of ownership.

Transactional approach

This business approach focuses primarily on a conventional exchange of goods and services such as, for example, the direct or indirect export or import of products. According to this approach, ties among partners are generally limited in terms of time and business dealings. The "transactional approach" is sometimes necessary in the case of companies operating in areas where the country of origin plays a significant role (e.g. champagne, French perfume, Canadian maple syrup, Mexican tequila). Compared with the other two means of penetration (discussed below), a transactional approach allows for a much simpler strategic withdrawal (much weaker exit barriers) on the part of the company.

Contractual approach
High customs duties, regulatory control, decreased production capacity and considerable freight transportation costs are among the many reasons that a company chooses a contractual approach when penetrating into a foreign market. The difference between this approach and the transactional approach resides in the considerable importance of the legal aspect in the contractual approach. The participation of legal advisors is recommended in this case. The terms of the agreement are intended to bind contractual parties (as far as the duration of the association, the sharing of resources and results are concerned). According to Mucchielli (1998), contractual approaches create more lasting ties than those resulting from transactional approaches and are less restrictive than the hierarchical ties between a parent company and a subsidiary (see structural approach). The contractual approach is preferable when it comes to the sale of services in a foreign country and technology transfer.

Structural approach
The structural approach results in a change to the corporate balance sheet. Investment and permanency are the main differences of this approach. A company will invest in a foreign country to delocalize its production or to get closer to the target market. Delocalization toward sources of raw materials or a qualified and affordable labour force may be even more important than being closer to the market in question (which could very well be in a third country). A structural approach will not necessarily eliminate the legal aspect that characterizes the contractual approach. In fact, quite the opposite is true.

Other observations and considerations

The medium-term costs of a project will often help determine the chosen means of penetration. As explained by Ciborra (1991), choosing among the various means of penetration will depend, for example, on how transaction costs compare with switching costs. In a case where transaction costs are greater than switching costs (e.g. costs related to setting up in a foreign country), a structural approach is recommended. In the opposite case (low transaction costs compared with switching costs), a transactional approach (e.g. export) is the best option. If both transaction and switching costs are high, a contractual approach (e.g. licensing agreement, franchise) is preferable.

It is interesting to note that certain variables can play a hybrid role as far as the two decision axes are concerned. These variables could help determine the level of integration and the means of penetration of the SME into the foreign country. The following table illustrates that a company’s financial resources, the vision adopted by its senior executives, and the geographical distance between the country of origin and the target country are just a few of the variables that determine a company’s level of commitment to a foreign country and the approach it chooses to adopt with that country.

Table 2
Examples of variables used to define the means of penetration and the level of integration of a company into a host country

	Company	*Market*	*Environment*
Integration variables	▪ Knowledge of the country's habits and customs ▪ Knowledge of the country's language ▪ Knowledge of the foreign market ▪ Desired control over the product	▪ Importance of after-sales service ▪ Importance of technical support ▪ Perception of intermediaries	▪ Living conditions in the host country ▪ ▪
Penetration variables	▪ Used vs. established production capacity ▪ Trade barriers ▪ Type of product (service) ▪ Transportation and insurance costs ▪ Patents, trademarks ▪ Ability to adapt the product to meet demand	▪ Market structure ▪ Market size ▪ Considerable degree of rivalry ▪ Area of activity ▪ Type of product (service) ▪ Stage of life cycle ▪	▪ Fiscal policy ▪ Incentives for foreign direct investment ▪ Infrastructure ▪ Local labour force ▪ Access to inputs ▪ Legal framework ▪ Market access (e.g. tariffs) ▪ Protection of intellectual property rights
Hybrid (circumstantial) variables	▪ Vision, intentions, hypotheses and objectives of senior executives ▪ Complexity of product ▪ Financial resources	▪ Perception of foreign products (companies) ▪	▪ Political risks ▪ Geographical distance

Conclusions, new avenues, and limitations of the model

The involvement of SMEs in foreign countries remains limited despite the fact that internationalization increasingly guarantees a company's survival. The step-wise approach (Uppsala school) seems to reflect less and less the reality of a certain category of SMEs that are expanding into foreign markets. Given the nature of products (services) and the area of activity in which they are expanding, companies are gradually adopting more sophisticated approaches (e.g. strategic alliances, joint ventures, direct investment) from the outset.

One of the model's first limitations involves the typology of the proposed strategies. Companies have a continuum of internationalization strategies available to them to the point where the lines between each generic strategy become blurred, as much on the horizontal plane (means of penetration) as on the vertical plane (degree of integration). In order to achieve the level of assurance needed to apply this tool, additional research avenues could focus on defining the relative importance of the variables as well as on the impact of information technologies on the chosen strategy for dealing with a foreign country. It would also be interesting to examine the relevance of this tool in the context of a large-scale company.

The aim of this study was to examine the decision-making process of managers of SMEs, given the wide range of internationalization strategy options available to them. The ultimate aim of the research project was to develop a tool that would make it possible to examine from a different perspective the decision-making process used by SMEs when developing international business strategies. The Mercadex-Desjardins model will therefore help orient the manager's thought process.

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Appendices

Figure 1
The Elements of an International Market Entry Strategy

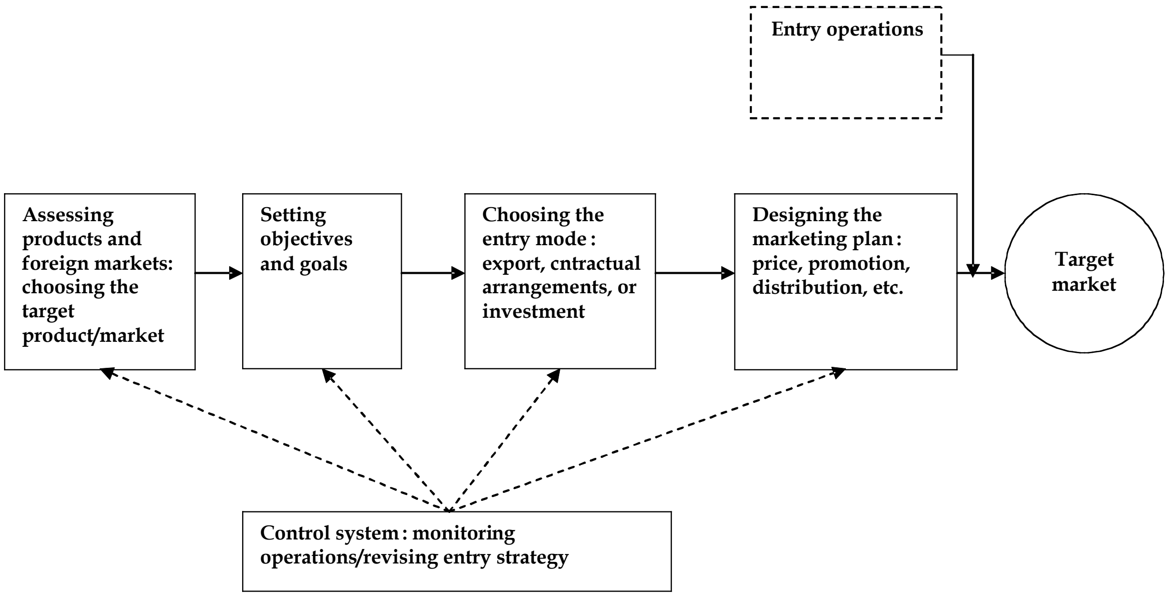

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Figure 2
Mercadex-Desjardins Internationalization Model