Trade Commissioner Service Centennial
1894 - 1994

Discussion Paper

The attached paper has been commissioned as a part of the "Look Ahead" component of the Trade Commissioner Service Centennial. It has been designed to engender consideration and discussion of trends and issues that will effect the direction of the service as it enters its second century.

The paper is not in any way a policy paper and must not be viewed or quoted as such. The views expressed are those of the author, and not of the Department of Foreign Affairs and International Trade or any component of it.

GLOBALIZATION: THREAT OR OPPORTUNITY FOR SMEs?

By John C. Banks
School of Business and Economics
Wifrid Laurier Universtiy

GLOBALIZATION: THREAT OR OPPORTUNITY FOR SMEs?

Over the last decade, globalization has become an increasingly important issue for business strategists and policy makers alike. Most of the discussion, however, has centred on how it has been impacting large diversified multinational corporations (DMNCs) and the adjustment processes they are having to undergo as a result. A great deal less attention has been paid to the effects globalization is having on SMEs.

Part of the reason for this is the sheer variety of SMEs across such dimensions as mission, technology, size, age, product/service line, and market scope. As such, they do not easily lend themselves to the development of broad generalization regarding the impacts of globalization. Nonetheless, a concerted effort should be made to really understand their particular challenges considering the major and integral role they play in the economies of most countries around the world. Take Canada, for instance. In 1991 over 98% of the approximately 922,000 businesses in the country had 100 or fewer employees. Moreover, they accounted for approximately 53% of the net jobs created in the private sector and produced about 45% of GNP.

The purpose of this paper is to contribute to an understanding of the threats and opportunities globalization poses for SMEs in particular. The first section provides a general overview of globalization. The second section discusses a way of classifying SMEs for the purposes of understanding how this process is impacting them. The third section provides a framework for identifying the types of impacts they are likely to experience in a given set of circumstances.

Globalization

Globalization is essentially a transformation process which results in an ever-widening definition of an industry's boundaries from local to national to regional to worldwide. When an industry has become completely globalized, that is, defined as worldwide, firms everywhere would be confronted with the same competitive conditions regardless of country location. In a fully developed global marketplace, goods, money, information and people would flow easily back and forth across national boundaries.[1]

Moreover, as a result of globalization, profound changes are taking place in the competitive conditions of an increasing number of industries around the world. Stimulated by technological advances, improvements in telecommunications and transportation, converging tastes, and changes in government policy, it has created a situation in which mere survival can require firms to pursue global strategies. It has also spawned a whole host of new business practices aimed at achieving a sustainable competitive advantage on a global basis including continuous improvement, benchmarking, total quality management, just-in-time inventory systems, re-engineering, designing for manufacturability and strategic alliances. So significant is this transformation process, in fact, that Peter Drucker has felt it necessary to issue the rather stern warning that "if you don't think globally you deserve to be unemployed, and you will be".[2]

Certainly, there is no question that thinking globally is important today. At the same time, however, it is worth noting that not all industries are being impacted by globalization to the same degree or at the same speed. Moreover, for industries which are globalizing significantly, some have been more negatively impacted by globalization than others.

To understand why, it is necessary to consider the effect industry conditions have on the process. Some industries are simply better structured for the transition to global status than others. A favourable industry structure for globalization would allow for the maintenance of profitability levels as adjustments took place. An unfavourable structure would result in a marked deterioration of profitability levels during the adjustment period, if not for many years thereafter.

Thus, to truly appreciate the extent to which globalization will impact the fortunes of firms, industry-specific factors such as tariff and non-tariff barriers, the potential to achieve economies of scale in key activities, the capital intensity of operations, and the heterogeneity of demand have to be examined.

Globalization and SMEs

When an industry begins to globalize, it is typically the large diversified multinational corporations (DMNCs) which are first to feel the effects and adjust their strategies. A broad range of responses have been adopted such as outsourcing, global production rationalization, product standardization, mergers and acquisitions, reorganizing into federations of autonomous business units and forming strategic alliances of various kinds. Only as DMNCs make the necessary changes do SMEs begin to experience directly the impacts of the evolving competitive imperatives of a globalizing world.

Even though little is really known about the nature of these second order impacts, globalization is viewed by some as being mainly a positive development for SMEs whereas others see it as mostly a negative development. On the positive side, it has been argued that globalization has actually given the advantage to SMEs at the expense of corporate giants. The opening of markets is removing many of the barriers which only DMNCs were able to surmount in the past making it easier for SMEs to sell their products all over the world. The use of computers is narrowing economies of scale in manufacturing and distribution. Factory automation is making it possible to produce goods cheaply in much smaller volumes. Drastic reductions in the price of computers is enabling SMEs to employ the same logistical techniques, sophisticated financial models, and automated payrolls and other administrative tasks that were available only to big firms in the past. The growing efficiency and internationalization of capital markets is allowing SMEs to raise money in much the same way as the global corporate giants. SMEs also now have access to the same quality control techniques as larger firms, eliminating the variation in quality between them that used to be common.[3]

Others see things quite differently. For them, the news is mostly bad. While plenty of opportunities may be opening up abroad, a necessary condition for SMEs to capture them is thinking about the entire world as their marketplace. If mastering this rather profound shift in mindset were not enough for firms involved in a daily scramble to obtain orders, get the product out the door and meet the payroll, there's more. The cost of overseas marketing is often relatively more expensive. As well, unique country differences in politics, culture, language, and economics must be observed, most of which SMEs will know nothing about.

SMEs also share several well-documented weaknesses which make it difficult for them to adjust their operations to the impacts of globalization. Their progress tends to be hampered by such things as management deficiencies in the area of marketing and financial control particularly in owner managed firms, lack of detailed strategic planning and inadequate resources or so-called resource poverty. They are also disadvantaged by directing most of their energies to satisfying the customers' immediate needs as opposed to monitoring potential threatening moves by competitors.[4]

Distinguishing Among SMEs — PG.17

The fact is that the news is necessarily neither good nor bad. It all depends on the circumstances in which the SME finds itself. To better understand these conditions and the sorts of threats and opportunities they create for the SME an analytical framework is developed below.

At the outset, however, a distinction must be made between SMEs which are industrial product/service providers and those which are final product/service providers. Industrial product/service providers are those firms supplying parts, components, capital goods or service to product/service providers further down the value chain. Final product/service providers are those dealing directly with the ultimate consumer.[5]

The distinction is important because the threats and opportunities faced by industrial product/service providers are a function of how globalization is impacting both its own and its customers competitive arenas. Indeed, a full accounting of the potential impacts would include an assessment of the impact of globalization on each industry represented in the value chain.

For instance, consider the value chain depicted below.[6] Each of the major activities involved in producing and distributing a pair of shoes represents a separate industry. In determining the threats and opportunities globalization is creating for a tanner, say, the firm would not only have to examine its own industry but also the shoe manufacturing industry, at the very least. Changes could also be taking place further downstream (ie., in the retailing industry) as a result of globalization which could eventually work their way back to the tanner as well.

Figure 1 - Shoe Manufacturing Value Chain

Transaction	Stage in the Value Chain					
	Hide Dealer	Tanner	Shoe Mfg	Wholesaler	Retailer	Consumer
Buys	Animal skins Chemicals Equipment Labor Energy	Hides Chemicals Equipment Labor Energy	Leather Heels Shoelaces Equipment Labor Energy	Shoes Space Equipment Labour Energy	Shoes Space Fixtures Labour Energy	Shoes
Sells	Hides	Leather	Shoes	Shoes	Shoes	

On the other hand, the threats and opportunities confronting final product/service providers are primarily a function of how significantly globalization impacts industry conditions at their particular stage of the value chain. Take, for instance, a SME composed of half a dozen stores selling shoes to the ultimate consumer in a particular mid-sized city. As a consequence of the increasing globalization of the mass merchandising industry, the local retailer could be faced with a dramatic changes in its competitive climate, especially if a global retailer opens up a store in its market area. In a worst case scenario, the SME, lacking a protected niche within which to operate safely, would find itself engaged in head to head competition with DMNCs. Unlike the situation with industrial product/service providers, then, the impact that globalization may be having on industry conditions further back in the value chain would be quite secondary to a determination of the threats and opportunities facing the local retailer.

Clearly, a great deal more needs to be learned about how globalization is impacting both types of SMEs. The focus here, however, will be on developing an understanding of the threats and opportunities being created for industrial product/service providers. Furthermore, the primary concern is with SMEs doing business with customers located in Canada. These customers could be serving either the domestic or international market and be either

Canadian or foreign controlled. In all cases, though, the customers would be major players in industries undergoing significant change due to globalization.

Distinguishing Among Customer Circumstances

As noted above, the fortunes of industrial product/service SMEs are tied to those of their customers. These, in turn, are a function of how globalization is affecting the nature of rivalry in their industries and of their relative competitive strength.

To gage how globalization can impact rivalry and thus the fortunes of the customer, the structural characteristics of its industry must be examined for they will influence how orderly and gentlemanly rivals will behave during its transition to global status. Industries can be classified as being generally favourable or generally unfavourable for globalization depending on their basic characteristics. Some of the key structural factors which determine the favourableness of a globalizing industry are shown in Figure 2 below.

Unfavourable structural factors will result in rivals having to compete in ways which drive costs up and profits down simply to stay in business. Until the dust settles, there will be little prospect of sustained profits. Favourable structural factors, however, allow firms to adjust their strategies in ways which are not detrimental to profitability levels in the industry.

Regardless of industry attractiveness, however, profitability levels could still be expected to vary among firms. Not all firms would fare equally well or equally poorly under the two conditions due to variations in relative competitive strength.

The relative competitive strength of the customer would be a function of its strategic and operating health. There are several factors in turn which determine strategic and operating health. These include market position, technology strength, product capabilities, financial resources and proprietary knowledge and skills.

Figure 2 - Industry Favourableness for Globalization

Structural Factors	Favourable	Unfavourable
Speed of boundary expansion	slow/consistent	rapid and/or erratic
Price levels	stable	unstable

Demand conditions	growing/certain	slowing/uncertain
Reinvestment requirements	none	high
Diseconomies of scale	none	substantial penalty
Excess capacity	little	substantial
Asset age	mostly old	sizable new
Extent of product differentiation	brand name loyalty	commodity-like
Customer industries	fragmented/weak	strong bargaining power
Customer switching costs	high	minimal
Height of exit barriers	low	high
Vertical integration	none	substantial
Degree of market segmentation	high	low

Identifying SME Opportunities and Threats

Combining industry and firm characteristics creates four basic scenarios in which SMEs' customers could find themselves as a consequence of globalization. These are shown in Figure 3.

Each of these circumstances would present the customer with a different set of strategic priorities and lead to a different set of strategic actions as it responded to the changing competitive conditions.[7] In turn, these responses would create different sets of opportunities and threats for the SME. The extent to which it would be able to take advantage of the opportunities or be exposed to the threats would be a function of its own strength relative to its competitors. Examples of how the SME could be impacted by each of these four circumstances are now discussed.

Figure 3 - Globalization Scenarios

Customer Competitive	Industry Structure for Globalization	
Strength	Favourable	Unfavourable
High	I	III
Low	II	IV

Situation I shown in Figure 3 represents the best case scenario for the customer. The combination of favourable industry conditions and competitive strength would enable it to focus on new opportunities arising because of globalization. Strategic adjustment would be deliberate and smooth. For a SME, this would create a multitude of opportunities. Depending on the particular strategy pursued by the customer, these could include partnering with the customer, extending its product line and /or market scope, increasing the value added to its product/service and even forming horizontal linkages with other SMEs to achieve the scale necessary to meet the customer's demands. The bottom line for the SME in these circumstances would be increased sales and/or profits. This scenario would not be without some threats, however. The SME in an attempt to keep up with its customer's demands could lose some strategic control over its direction and become over-extended in the process. On the other hand, the patronage of the customer could be lost altogether if the SME was not able to keep up with the demands being made on it.

Situation II would be a less desirable scenario for the customer although it may not appear as such in the short term. In fact, the big danger here is that a competitively weak customer could be shielded for a time from the impacts of globalization due to the favourable industry conditions. Whatever deterioration in its fortunes which did occur could be attributed to temporary external forces. When the situation was recognized for what it truly was, the customer would in all likelihood have to mount a concerted, if not sudden, effort to attempt to regain its former position. This would create an opportunity for the SME to develop stronger ties with the customer through helping it to adjust to the changed environment. On the other hand, if the SME were to become aware of the situation before the customer, it could begin to forge links with stronger potential customers. This scenario would present the SME with several threats, however. Depending on the strategic adjustment pattern of the customer and the SMEs foresight, these could include stalled or slowing sales growth, increased costs, technological decline and being blind sided by competitors.

Situation III is again less desirable than I but by no means necessarily worse than II. Even though the industry conditions would be unfavourable, the strong competitive position of the customer would enable it to survive far better than many of its rivals. Its strategic agenda would likely have something to do with repositioning itself to safer segments in the industry while diversifying into related or new industries with more promising growth and profitability prospects. Its responses would likely be emergent rather than deliberate, its pacing moderate but somewhat uneven while its shifts in current strategy could be fairly significant. Due to the customer's strength, the SME would be somewhat buffered from the full impact of deteriorating competitive conditions. The opportunities would be few, however, and primarily associated with following the customer into new product/markets. The threats would be many and include a combination of those evident in scenarios I and II. Depending on the strategic action of the customer, these might include over expanding, loss of strategic control, increased costs and stalled or slowing sales growth.

Situation IV would represent the worst case scenario for the customer. A combination of unfavourable industry conditions and poor competitive strength would put its survival at significant risk and require sudden and significant shifts in strategic direction. This would translate into tremendous pressure being felt by the SME to make rapid, significant and likely erratic changes to its own strategy. The only real opportunity here would be to seek new customers among the stronger firms in the industry. Even this, however, would at best provide only temporary relief. Not surprisingly, this scenario would present the SME with a multitude of threats. Depending on the response of the customer, these would include severe sales decline, insolvency, bankruptcy, predatory competition in its own industry and takeover.

A summary of the various threats and opportunities a SME could face under each of these scenarios is provided in Figure 4. The list is not intended to be exhaustive but merely representative of the sorts of general conditions SMEs would face under each of the scenarios. Specific threats and opportunities at the firm level would have to be identified by an analysis of the SME's particular situation. Nonetheless, it should be noted that generally the opportunities decrease and the threats increase as the situation shifts from the upper left hand quadrant to the lower right quadrant. Moreover, regardless of the competitive strength of the SME, the opportunities would normally be harder to take advantage of and the threats harder to avoid as the situation shifts from the upper left hand quadrant to the lower right hand quadrant.

Figure 4 - Globalization Threats and Opportunities for SMEs

Customer's Competitiveness

High

Opportunities

- form horizontal alliances with other SMEs
- partnering with customer
- product line extensions
- geographic expansion
- increase value added
- increase size
- increase profitability

Threats

- **over extension**
- **cannot keep up with customer**
- **loss of strategic control**

Opportunities

- follow customer into new products/markets

Threats

- **over expansion**
- **stalled/slowing growth**
- **loss of strategic control**
- **increased costs**
- **declining profits**

Customer's Industry Structure

Favourable

Unfavourable

Opportunities

- stronger ties with customer
- forge links with new customers

Threats

- **stalled/slowing sales growth**
- **increased costs**
- **technological decline**
- **being blind sided by competitors**

Opportunities

- seek new customers

Threats

- **loss of customer**
- **severe profit decline**
- **downsizing**
- **takeover**
- **predatory competition**
- **bankruptcy**
- **deinternationalization**

Low

Conclusions

Globalization is an increasingly pervasive phenomena in the world economy. For SMEs it presents both opportunities and threats, the extent and nature of which will be a function of several factors. The most important of these would be industry conditions and the relative competitive strength of the firm.

In order to address the issue at hand in a meaningful way, the focus of this discussion was narrowed to industrial product/service providers operating in a specific set of circumstances. Nevertheless, the reasoning embodied in the proposed framework could be easily extended to a broader set of circumstances or to final product/service providers.

The bottom line is that there is no universal catalogue of opportunities and threats which apply to all SMEs in all situations. Neither are there any generic means available for capturing the opportunities or avoiding the threats. What the proposed framework can do, however, is to provide managers and government officials with a systematic way of thinking about the impact globalization is likely to have on a given SME.

Endnotes

1.For instance, see Koh Sera, "Corporate globalization: a new trend", The Executive, Vol. 6, No. 1, February 1992, pp. 89-96; Henry Wendt, Global Embrace: Corporate Challenges in a Transnational World. New York: HarperCollins, 1993.

2.Quoted in David R. Francis, "Global Frontiers of Business", The Christian Science Monitor, April 11, 1991, pp. 9-11.

3.See Robert Howard, "Can Small Business Help Countries Compete", Harvard Business Review, November-December, 1990, pp. 88-90+; "The Fall of Big Business", The Economist, April 17, 1993, pp. 13-14.

4.See Isaiah A. Litvak, "Instant International: Strategic Reality for Small High-Technology Firms in Canada", Multinational Business, No.2, Summer 1990; Theodore Peridis, "Small Hi-Tech Businesses Grow Global", Business Quarterly, Spring 1992, pp. 42-48; Bonnie Heineman Wolfe, "Finding the International Niche: A 'How to' for American Small Business", Business Horizons, Vol. 34, No. 2, March/April 1991, pp. 13-17.

5.See for instance Gordon H.G. McDougall, Philip Kotler and Gary Armstrong, Marketing, Canadian Second Edition. Scarborough, Ontario: Prentice-Hall Canada Inc., 1992

6.Ibid.

7.See Edmund Faltermayer, "U.S. Companies Come Back Home", Fortune, December 30, 1991, pp. 106-108+; Lawrence G. Franko, "Global Corporate Competition II: Is the Large American Firm an Endangered Species?", Business Horizons, Vol.34, No.6, November/December 1991, pp. 14-22; "The Global Economy: Who Gets Hurt", Business Week, August 10, 1992, pp. 43-53.