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THE ASPECTS OF MANAGING RISKS IN CONNECTION WITH THE INTERNATIONALIZATION OF SMES FROM SELECTED CENTRAL EUROPEAN COUNTRIES

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Abstract

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Insufficient domestic demand and increasing competition force small and medium-sized enterprises (SMEs) to engage in internationalization process and enter to foreign markets. This process, however, carries risks that should be appropriate managed. In order to identify similarities and differences in the approach of SMEs from selected Central European countries towards managing these risks and find out whether perception of risks differ based on domestic country of the SMEs, questionnaire survey among Czech, Slovak, German, Austrian and Poland SMEs was performed in 2014. It was found that more Austrian and German SMEs, compared to Czech, Slovak and Polish SMEs, do not apply any method of risk analysis but are more focused on some form of protection in international operations. As the most common form was identified payment in advance. It was also found that Austrian and German SMEs prefer to use bank products rather that conclude long-term contracts or verify the credibility of their foreign business partners used by Czech, Slovak and Poland SMEs. Based on statistical testing, significant differences appeared in risk perception of SMEs from different countries. Especially perception of market risks, transportation risks and risk of natural disasters.

Keywords: small and medium-sized enterprises, internationalization, Central Europe, managing risks, risk perception, risks of internationalization, market risks, transportation risks.

INTRODUCTION

The aim of this paper is to find the similarities and differences in the approach of small and medium-sized enterprises from selected Central European countries of towards managing risks in internationalization and determine whether SMEs from different countries perceive the risks connected with internationalization differently. Is it possible, for example, to determine whether SMEs from the Czech Republic perceive transportation risks in internationalisation as higher than SMEs from Germany? These are the questions we mean to answer.

Each country is characterized by its unique economic, legal, social and business environment which also influences the course of managing the business activities of its enterprises. Thus, it can be assumed that enterprises from different countries perceive a different level of risk in foreign markets depending on the environment from which they come, and that they apply different methods of managing those risks. However, previous studies suggest that small and medium-sized enterprises in general do not deal with risk management to a great extent. This is probably caused by the lack of resources both in terms of suitable employees and finance or because they are not aware of the usefulness of risk management methods and their practical implications. Although the individual risk management processes are often not applied in SMEs, they still to some extent perform some activities to eliminate the risks to which they are exposed in their business activities or transactions such as hedging their contracts and business operations, identifying potential customers, tracking the solvency of their customers etc. This paper thus focuses on the approach of SMEs to some aspects of the risk management process they apply in their foreign trade operations within the framework of internationalization.

Internationalization is for SMEs a much more complex and challenging issue than for large multinational organizations which are characterized by sufficient human and capital resources and have a significant international experience. Moreover, business activities of SMEs are more affected by changes in the environment. Therefore, it is perhaps more important for SMEs to focus on risks which may evolve during their internationalization process and search for ways of securing their foreign business transactions. The research on SMEs in internationalization is still insufficient, although SMEs are the core of any European economy in terms of their share in the total number of enterprises, their share in added value created in the economy and the share in the employment rate.

Globalization, growing competition and declining demand in domestic markets have forced many small and medium-sized enterprises to enter foreign markets in the last decades. Although, new technologies allow SMEs easier access to foreign markets, these enterprises still have to face a certain degree of risk in the process of internationalization.

Several approaches to the internationalization process have been examined by many authors in previous studies (Madsen and Servais 1997; Shrader *et al.* 2000). These approaches are distinguished mainly by how great a risk these enterprises face and what opportunities they are presented (Johanson and Vahlne 1977). These factors then influence how quickly enterprises enter foreign markets.

Korsakienė and Tvaronavičienė (2011) state that four approaches to the internationalization process exist on which internationalization studies are based. These are stage, learning, contingency and network approaches. On the other hand, Laghzaoui (2011) or Islam, Masum and Fernandez (2008) have described three approaches to the internationalization process (stage, economic and network). A newer approach is mentioned in a study by Kunday and Şengüler (2015) who describe three main theories, namely: Traditional international theory, Network theory (e.g. Emerson 1981; Mitgwe 2006) and the Modern approach theory (e.g. Çavusgil and Knight 2009; Knight 1997). It should be noted that Traditional international theory has become the basis for other internationalization theories which arose from it. Based on these finding, the authors focus on the Uppsala theory.

The process of internationalization entails a number of risks. Enterprises should identify and appropriately respond (manage) them to avoid their harmful effects (Verbano and Venturini 2013) and increase the probability of success (Kubíčková 2013). Vochozka and Mulač (2012) mention two different approaches to risk management, which can be defined as a process which aims to reduce risk and protect the assets of the enterprise against losses (Urciuoli and Crenca 1989). These approaches can be called Intuitive and Systematic. The Intuitive approach is typical for small enterprises and start-ups. These enterprises manage risks by intuition of management based on acquired knowledge, education or experience (Clayton 2009). Intuition is a highly subjective feeling and it is very dangerous to use it as a part of risk management (Askari *et al.* 2012). This approach can be seen as the simplest risk management process. More sophisticated is the Systematic approach, which uses various tools and techniques to manage risk. Usually it consists of four stages: risk identification, evaluation and quantification of potential consequences, management of risks and risks development reporting (Andersen 2006; Palojarvi 2009; Vaughan and Vaughan 2001). It should be mentioned that these stages may vary depending on the author. Various tools are also used to manage risk. For example Sensitivity analysis, Risk map analysis, Decision Tree analysis or analysis of Monte Carlo (see e.g. Cowan 2005; Mistikoglu *et al.* 2015; Pereira *et al.* 2014).

As stated, the first stage of risk management is usually risk identification. In this stage, enterprises have to determine which risks they may encounter in the process of internationalization. Generally, any event (expected or unexpected) which affects the objectives of an enterprise can be identified as a risk (Jayathilake 2012). Usually, risks are divided into two main categories – static risks and dynamic risks (Mowbray *et al.* 1979). Static risks are those events that have a negative effect on the enterprise (e.g. building fire or theft of goods, etc.). On the other hand, dynamic risks are those that can cause negative or positive effect. These risks outweigh and outnumber static risks (Fotr and Souček 2011) and are the typical entrepreneurial risks (Mowbray and Blanchard 1979).

Bielawska (2006) and Fudaliński (2014) state that there are three main risk types for an internationalized enterprise – Individual risk (credit risk, contract risk and risk in business partners), Market risk (economic risk, risk of price changes and general risk) and Country risk (economic risk and political risk). Further, they argue that individual and market risks are higher for internationalized enterprises in comparison with enterprises which do not operate on foreign markets. It was also determined that SMEs which operate on foreign markets perceive individual and market risks as the most important (Straka 2014).

Although it is not possible to completely eliminate identified internationalization risks, enterprises have to be able to deal with them. Hopkin (2010) suggests several methods of dealing with risks based on a risk matrix. High probability risks with high consequence should be reduced or avoided. High probability risks with low consequence should be reduced or tolerated. Which of these methods enterprises choose depends on their individual risk attitudes, current market position and other factors. On the other hand, low probability risks with high consequence should be avoided or insured and risks with low consequence can be tolerated (see Hopkin 2010, p. 246). It should also be noted that proposed solutions are not applicable in all situations and are often influenced by experience and the subjective approach of individuals (Smejkal and Rais 2003).

Jensen (2012) and Rodriguez *et al.* (2010) mention other methods of managing risks. For example, aggressive business management, diversification, flexibility of enterprise, risk sharing, obtaining additional information, forecasting etc. Selection of a suitable method then depends on the type of risk.

As was mentioned, the size of risk also depends on the perceived risk of entrepreneurs and the psychic distance of the foreign market (Machková *et al.* 2010). While the perceived risk is more or less subjective and differs based on gathered information or business experience of entrepreneurs, the psychic distance can be considered as typical (in context of one country). Many authors have dealt with the issue of psychic distance (e.g. Evans *et al.* 2000; Linnemann 1967). For example, Erramilli (1991) and Hitt *et al.* (2005) confirmed that there is a relationship between psychic distance and the method of SMEs' entry to the foreign markets. If the enterprise enters markets with greater psychic distance, they face a higher risk and choose a less risky method of entry. Similar data was presented by Figueira-de-Lemos *et al.* (2011) and Johanson and Widesheim-Paul (1975) within the Uppsala model.

MATERIALS AND METHODS

The results and conclusions presented in this paper are drawn from primary data collected by a questionnaire survey which was performed in 2014. The respondents were small and medium-sized enterprises from the Czech Republic and neighbouring countries (Slovakia, Germany, Austria and Poland). The questionnaire was created as an electronic form and distributed to enterprises via e-mail. It was necessary to create 4 versions of questionnaires, in Czech, Slovak, Polish and German. The response rate was, however, very low (about 1 %) which could have been caused by the unwillingness of enterprises from foreign countries to take part in a survey conducted by the university from other than their home country, or by spam control installed in e-mail boxes of the questioned enterprises or by the electronic form of the questionnaire which is, on one hand, not as costly but, on the other hand, not as effective in addressing the respondents as a paper questionnaire would be. The total number of respondents that took part in the survey and their characteristics are shown in Table I.

The data processing utilised the relative frequencies; hypothesis testing was also performed. The Kruskal-Wallis test was applied in order to determine whether there are some differences in means among groups of respondents that are being compared. The null hypothesis states that there are no differences in means among groups of respondents (Dodge 2008). The null hypothesis was rejected and an alternative one accepted when the calculated p-value was lower than the significance level. The level of significance was set as 0.05. Subsequently, the multiple comparison of p-values was applied which can reveal the particular groups between which significant differences are present. The null hypothesis states there are no significant differences between the particular compared groups.

RESULTS

The approach of Central European SMEs towards managing risks associated with their foreign business operations was examined from three different points of view in this paper to obtain a complex insight into the risk management practices these companies apply in their internationalization. First of all, the SMEs answered the question about the methods of risk analysis (a key part of the entire risk management process) which they applied before their foreign market entry. The focus was to establish whether SMEs consider risk analysis a crucial step in decision-making about their internationalization. Then, a question regarding the current level of risk management in the enterprise followed, in order for us to acquire information about the level of maturity of risk management in the particular enterprise, which might possibly

I: *Number of respondents from selected countries*

Category of respondents	Czech Republic	Slovakia	Poland	Austria	Germany
Micro enterprises (0-9 employees)	21	39	22	41	10
Small enterprises (10-49 employees)	72	53	38	33	8
Medium enterprises (50-249 employees)	109	30	29	9	26
Total number of SMEs	**202**	**122**	**89**	**83**	**44**

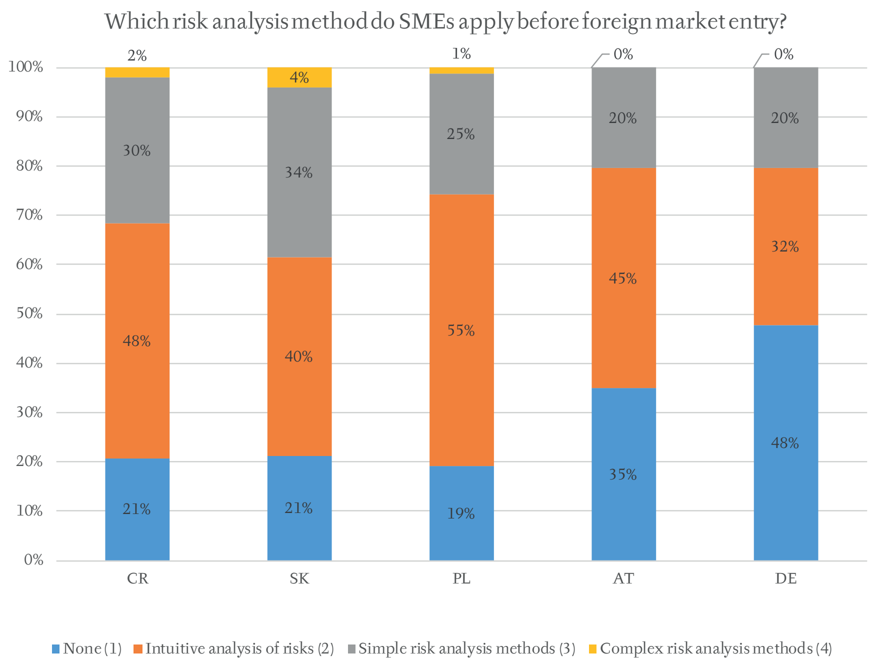
Source: author's research

influence the way of the enterprise's thinking about risks in international business. Finally, the SMEs were asked about the particular forms of hedging in international business operations which they commonly use to find out whether at least the risk treatment as a part of the overall risk management process is enhanced in internationalization. The comparison between SMEs from the Czech Republic and its neighbouring countries (Germany, Slovakia, Poland and Austria) was performed intentionally in order to depict the significant similarities or differences in the management of international activities within the enterprises from countries that are the Czech Republic's main business partners in international trade.

Figure 1 shows the comparison of risk analysis methods applied in the internationalization process by SMEs from selected countries of Central Europe. The SMEs involved in the survey can be divided into four groups regarding their answers to the question about risk analysis methods: enterprises that did not even consider analysing any risks before entering foreign markets (1), enterprises that analysed the potential risks in an intuitive manner rather than by applying a specific method (2), enterprises that applied at least some simple methods of risk analysis in a decision making process about foreign market entry (3) and enterprises that applied some more complex risk analysis method within the decision-making process of their internationalization (4).

The intuitive approach means that the enterprise did think about the potential risks before entering a foreign market but it worked with its previous experience in internationalization or with obtained information about particular foreign market/partner. The simple risk analysis methods cover for example risk matrixes that graphically display the level of particular risk by combining the probability of risk realization and the impact of risk on an enterprise's activities, both of which are assessed rather verbally then statistically/mathematically. The complex risk analysis methods cover for example more sophisticated statistical methods used for decision making (such as decision trees) or Monte Carlo analysis.

Surprisingly, only a small percentage of SMEs from each country applied some complex risk analysis method; indeed, in Austria and Germany, none of the respondents chose this option. At least simple risk analysis methods are also not very popular among SMEs in Central Europe. However, they are applied more often by SMEs from Slovakia (34 %) or the Czech Republic (30 %) than by SMEs from Poland (25 %), Austria (20 %) or Germany (20 %). With the exception of SMEs from Germany, it can be concluded that the most commonly applied approach to analysing risks when considering the involvement in international business operations for SMEs from all countries is the intuitive attitude based on previous experience or obtained knowledge. With regard to the last option – no risk analysis – the SMEs can be divided into two groups. First group consists of SMEs from the Czech Republic, Slovakia and Poland where only about one fifth of SMEs did not analyse any risks before foreign market entry. Second group could contain SMEs from Austria and Germany where more than one third (35 %) or even almost one half (48 %) of SMEs did not take any measures to analyse the potential risks when considering the involvement in internationalization. In summary,

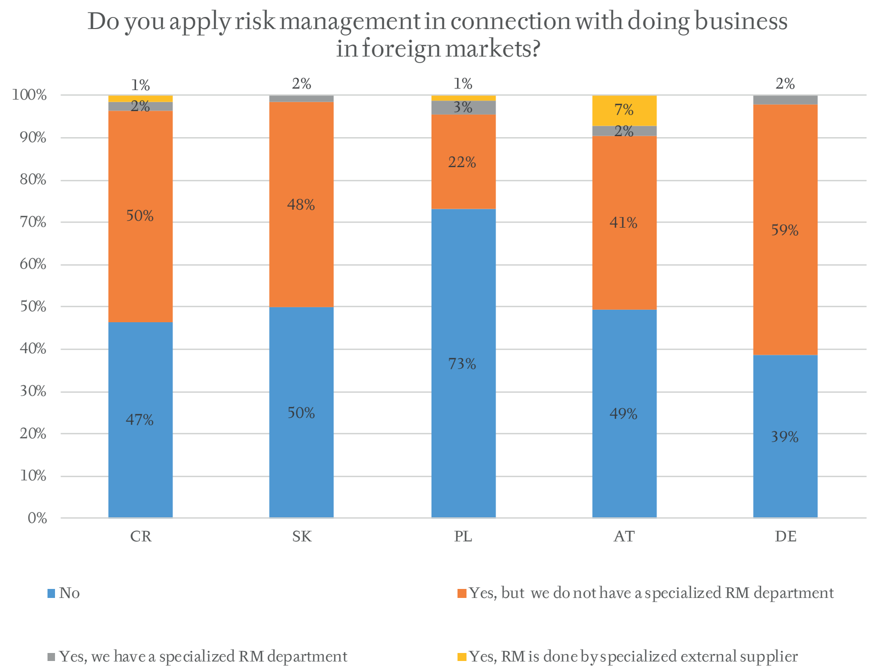


1: *Methods of risk analysis applied in internationalization (Source: author's research)* with some approximations the results indicate that the approach towards analysing the potential risks in the internationalization is similar for SMEs from the Czech Republic, Slovakia and Poland and for SMEs from Austria and Germany.

However, risk analysis is only one part of the overall process of risk management. As previous surveys show, risk management within SMEs is not as developed in general. Therefore the respondents were asked how the risk management is done and whether they deal with risk management internally or externally. The results are shown in Figure 2. The SMEs involved in the survey can be divided into 4 groups: SMEs that do not deal with risk management at all (1), SMEs that deal with risk management in spite of not running their own specialized RM department because the most important risk management tasks are handled by other departments in the firm (2), SMEs that have their own RM department and thus apply risk management in all business processes (3) and SMEs that put some external supplier in charge of their risk management processes, thus outsourcing the risk management (4).

The results regarding the approach towards risk management in SMEs from selected Central European countries indicate that these enterprises do not apply a proper risk management process in general, as only a minor percentage (2-3 %) of enterprises from all selected countries have their own specialized RM department or outsource their RM processes to specialized external suppliers. Only SMEs from Austria differ to a lesser extent regarding this issue as 9 % of respondents from Austria deal with risk management processes properly (see Figure 2). At the same time the external suppliers of RM services are employed to the greatest extent only by the SMEs from Austria (7 %). However, approximately half of the SMEs from the Czech Republic, Slovakia and Austria stated they do not deal with risk management at all. In case of SMEs from the Czech Republic and Slovakia the other half of SMEs stated they deal only with the most important risk management tasks; although they do not have a specialized RM department, these tasks are handled by other departments in a firm. In case of SMEs from Poland, the results are even more surprising, since almost three quarters of the questioned Polish SMEs do not deal with risk management at all and of the remaining quarter of respondents the prevailing majority deal with risk management only to a lesser extent as they put the other departments in charge of the most important RM tasks. A different picture can be seen in case of SMEs from Germany, where less than 40 % of respondents show no interest in RM practices whereas almost 60 % of respondents are aware of RM significance in the business process and therefore process the important risk management tasks at least in other non-specialized departments.

Nevertheless, the results regarding methods of insurance applied in foreign trade activities revealed that although the majority of SMEs stated they do not deal with risk management in their internationalization at all, they still somehow pursue at least a part of the overall RM process as the prevailing majority of respondents try at least to secure their foreign trade activities which means they deal to some extent with risk treatment. Figure 3 shows how popular different methods of insurance in internationalization are among SMEs



2: *Risk management in SMEs (Source: author's research)* from selected countries of Central Europe (only the most frequent methods are included).

It can be noted from Figure 3 that only a small portion (7 % resp. 11 %) of SMEs from Austria resp. Germany do not use any securing of foreign business operations and in case of Polish, Slovak and Czech SMEs the share of those that do not secure their foreign trade activities reaches between 13 % and 20 %.

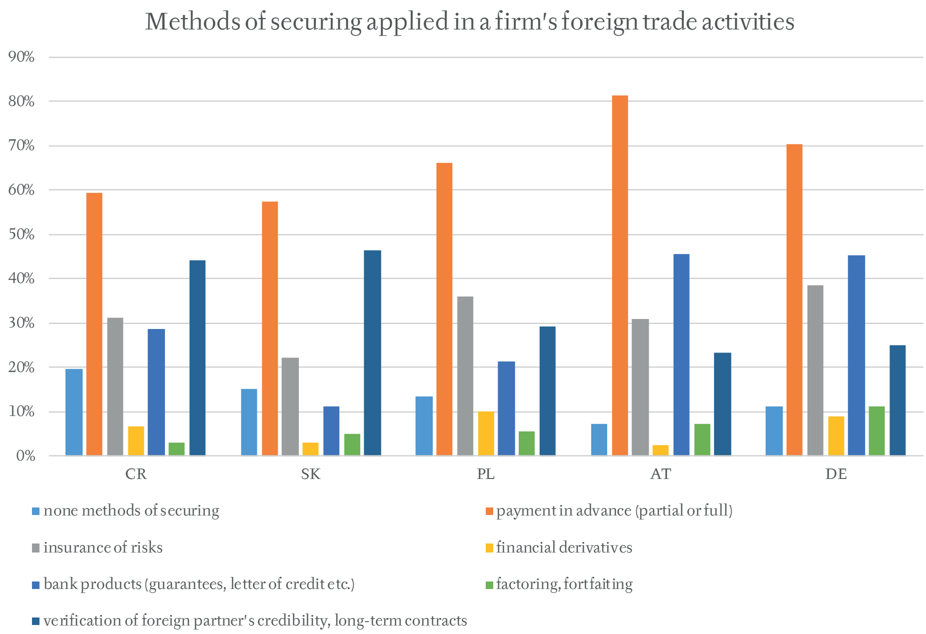
Partial or full payment in advance is a very popular tool used by SMEs from all countries when trading internationally. This method is used mainly for insuring against the commercial risks associated with the reliability of business partners and enables to decrease the potential amount of loss in case of breach of contract. The payment in advance is applied by almost 60 % of SMEs from both the Czech Republic and Slovakia, in case of German and Austrian SMEs the proportion in even higher (70 % resp. 81 %) which indicates that SMEs from these countries may have a stronger negotiating position in business relationships in comparison with SMEs from other selected countries.

The insurance of international risks (such as transportation insurance, commercial insurance etc.) is most frequently applied measure by SMEs from Germany (39 %) and less frequently applied by SMEs from Slovakia (22 %). It is often discussed that this form of securing is very financially demanding, yet very effective in case of breach of contract or other unexpected events.

Not very popular methods of securing in internationalization of SMEs from selected countries are financial derivatives which protect against foreign exchange risk and factoring (forfaiting) which secure the commercial risks. Both are applied at most by 10 % of SMEs from any country involved in the survey.

Differences arose regarding the use of bank products such as guarantees, letter of credit etc. and the use of long-term contracts and permanent verification of business partner's credibility. The SMEs involved in the survey can be divided into two groups: SMEs from the Czech Republic and Slovakia (1) and SMEs from Austria and Germany (2). SMEs from the Czech Republic and Slovakia do not secure their foreign business operations by bank products (letter of credit, bank guarantees etc.) to a great extent, but they more often tend to conclude long-term contracts or verify the foreign partner's credibility. On the contrary, SMEs from Germany and Austria tend to use bank products as a security in foreign trade operations to a greater extent, but they do not very often conclude long-term contracts or verify the credibility of their foreign business partners.

Differences may lie not only in managing risks but also in the level of perceived risks that are often encountered in the internationalization by enterprises from different countries. The conditions and requirements of doing business abroad are for enterprises from each country diversely demanding or harmonized. We wanted to find out whether there are some differences in perception of particular risk factors connected with internationalisation (such as market risks, economic risks, cultural risks etc.) among SMEs from the Czech Republic, Slovakia, Poland, Austria and Germany. The addressed SMEs were asked to evaluate their perception of particular risk factors on a 6 point scale, where 1 meant the least risky factor and 6 meant the most risky factor. With regard to this intention, the Kruskal-Wallis test was applied, which revealed some differences



3: *Risk management in SMEs (Source: author's research)* in perception of risk factors regarding the particular country. The results of the Kruskal-Wallis test are shown in Table II. The focus was placed on the most common risk factors in international trade; thus, the following risks were involved in the survey: risks in corporate strategy (1), risks stemming from the firm's size (2), political risks (3), economic risks (4), social risks (5), risk of natural disasters (6), risks associated with business partners (7), market risks (8), transportation risks (9), legal risks (10) and finally cultural risks (11).

Risks in corporate strategy (1) comprises of the choice of unsuitable forms of market entry, the use of unsuitable methods of funding in international operations, the deficiencies in supplies etc. Among risks associated with the enterprise's size (2), we could include difficulties with the lack of capital, production capacity, flexibility of responses to changes etc. Political risks (3) cover problems such as the possibility of governmental changes, changes in political regime etc. Economic risks (4) represent the risks of unexpected inflation, changes of interest or tax rates, changes in foreign exchange rates etc. Social risks (5) cover issues such as crime and terrorism and natural risks (6) issues such as floods or storms which may influence the deliveries to foreign markets or production in foreign markets. Risks of business partners (7), often called commercial risks, contains factors such as unreliability of suppliers, insolvency of foreign customers, withdrawal of a foreign customer from the contract etc. Market risks (8) include factors such as the entry of new competition to the market, changes in the customer's preference, lack of information about customers etc. Transportation risks (9) cover high transport costs, lack of knowledge of distribution channels, delays in deliveries etc. Legal risks (10) are connected with factors such as changes in laws affecting the international trade, different law systems and standards etc. Finally, cultural risks (11) stem from different languages, customs and traditions across countries.

The null hypothesis in the Kruskal-Wallis test for each risk factor was set as: There are no differences in means among groups of respondents (H_0). Thus, the alternative hypothesis was set as: There are differences in means among groups of respondents (H_1).

Statistically significant differences appeared in the level of perceived market risks, transportation risks and risk of natural disasters. That means that SMEs from different Central European countries perceived the market risks differently. The assessment of multiple p-values refers to the fact that the market risks are perceived differently by SMEs from the Czech Republic and Germany and other differences appeared in the perception of market risks by SMEs from Slovakia and Germany. SMEs from the Czech Republic or from Slovakia perceived this risk factor as more intense than German SMEs did. The explanation may lie in the fact that SMEs from these countries have different export markets and that the state of entrepreneurial environment is thus different, which influences also the level of perceived market risks.

Other statistically significant differences were found in the perception of risk of natural disasters and transportation risks. With respect to the risk of natural disasters, the only difference occurred between SMEs from Slovakia and Austria and with respect to transportation risks, the significant differences can be found in the perception of Czech and German SMEs. Czech SMEs perceive this risks as more intense than German SMEs. The level of perceived transportation risks may be influenced by the type and extent of transportation insurance used, by the distance of transportation and by the bargaining power of enterprises when concluding contracts with favourable conditions (low responsibility for transport of products to foreign markets).

II: *The Kruskal-Wallis test: the differences in perception of internationalization risks among SMEs from different countries*

Perception of particular risk in internationalization regarding SMEs from different countries	The results of Kruskal-Wallis test		
	p-value	Groups in which the differences appeared	Multiple p-value
Risks of corporate strategy	0.3066	No statistically significant result	-
Risks stemming from the firm size	0.1463	No statistically significant result	-
Political risks	0.7421	No statistically significant result	-
Economic risks	0.3357	No statistically significant result	-
Social risks	0.9194	No statistically significant result	-
Risks of natural disasters	0.0291 **	SK x AT	0.0685 *
Risks of business partners	0.1813	No statistically significant result	-
Market risks	0.0030 **	CR x DE	0.0102 **
		SK x DE	0.0038 **
Transportation risks	0.0739 *	CR x DE	0.0702 *
Legislative or legal risks	0.1703	No statistically significant result	-
Cultural risks	0.5985	No statistically significant result	-

Source: author's research

Notes: * significant at α = 0.10, ** significant at α = 0.05, CR = SMEs from the Czech Republic, SK = SMEs from Slovakia, AT = SMEs from Austria, DE = SMEs from Germany

DISCUSSION AND CONCLUSION

The aim of this paper was to find the similarities and differences in the approach of SMEs from selected Central European countries towards managing risks in internationalization and moreover to find out whether SMEs from different countries perceive the risks connected with internationalization differently.

The paper provides insight into the risk management practice applied in internationalisation by SMEs from the Czech Republic, Slovakia, Poland, Austria and Germany. These countries were chosen since they are the neighbouring countries of the Czech Republic and also its main business partners. SMEs from each selected country were asked separately about the approach to risk analysis which should be applied before the foreign market entry, about the level of risk management they apply and finally also about the method they employ to secure their foreign business operations against risk connected with internationalisation.

Regarding the risk analysis some interesting similarities appeared in the approach toward analysing the potential risks connected with internationalisation by SMEs from the Czech Republic, Slovakia and Poland and by SMEs from Austria and Germany. Interestingly, more than one third or even almost one half of SMEs from Germany or Austria did not apply any method of risk analysis compared to SMEs from the Czech Republic, Slovakia and Poland where only about one fifth of these SMEs did not analyse potential risks connected with their foreign expansion.

Many previous studies on risk management suppose that SMEs do not focus on managing risk in general. The results of this paper refer to the fact that only a minor percentage (2–3 %) of SMEs from selected Central European countries have their own specialized RM department or that they enhance their risk management process externally. However, the results indicate that the overwhelming majority of respondents at least try to deal with risk treatment, e.g. they try to secure their foreign business activities against risks. Only a small percentage of SMEs from Austria or Germany (7 % and 11 % respectively) do not use any form of protection in international operations compared to Polish, Slovak and Czech SMEs, where is this proportion higher and reaches between 13 % and 20 %.

Regarding risk treatment, some similarities arise. A quite commonly used form of protecting against risk is the payment in advance which is applied by almost 60 % of SMEs from the Czech Republic and Slovakia and even in great extent by German and Austrian SMEs. Moreover, German SMEs applied also the insurance of international risks (such as transportation insurance, commercial insurance etc.) which is quite financially demanding. Regarding the use of bank products (for example guarantees, letter of credit etc.) and the use of long term contracts and permanent verification of a business partner's credibility, SMEs could be divided into two groups according to their approach to this particular methods. Czech and Slovak SMEs do not use the bank products to a great extant, but they conclude long-term contracts or verify the foreign partner's credibility. On the other hand, SMEs from Austria and Germany prefer to use bank products rather than conclude long-term contracts or verify the credibility of their foreign business partners.

Furthermore, the paper also dealt with the risk associated with internationalisation. The goal was to determine whether there are some differences regarding the risk perception of SMEs from different Central European countries. In order to identify the differences, the Kruskal-Wallis test was applied. Statistically significant differences appeared in the level of perceived market risks, transportation risks and risk of natural disasters.

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