




“Breaking into the international market: Net income and margin improvement for Spanish SMEs”

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BREAKING INTO THE INTERNATIONAL MARKET: NET INCOME AND MARGIN IMPROVEMENT FOR SPANISH SMEs

Abstract

This study examines the dynamics of internationalization and globalization efforts of Spanish small and medium-sized enterprises (SMEs). The study aims to assess the number of Spanish SMEs engaged into international trade and benefits and risks (e.g., associated with the COVID-19 pandemic) such a process can bring. Empirical analysis of data from the Spanish Ministry of Industry provides an overview of the percentage of SMEs engaging in international activities, i.e., exporting their products and services. The results capture the critical differences between exporters and those companies that target only domestic customers and confirm that the number of newly established SMEs is growing. However, the number of exporters is decreasing or range at the same level. Only 5.48% of Spanish SMEs actively participate in international activities, and very few are involved in real internationalization. The results confirm the existence of economic growth for exporting companies that significantly impact regional and international efficiency, especially those who previously worked on research and market performance. The larger the exporting company, the higher its revenue. In addition, exporters are far more significant and considerably more productive than those companies that choose not to engage in exports.

Keywords

SMEs, globalization, innovation, technologies, strategies, COVID-19

JEL Classification

M16, L21, L25

INTRODUCTION

According to the Spanish National Statistics Institute (INE, 2021), in 2021, there were 12,953 subsidiaries of foreign industrial, commercial, and non-financial services in the Kingdom of Spain. SMEs generated 61.3% of the Gross Domestic Product and 71.9% of total employment in Spain. Between 2016 and 2021, the value of SMEs increased by 19% and employment by 13.5%. Before the pandemic, SMEs predominated in Spain, comprising 99.81% of companies, totaling 3,358,603. However, the pandemic reduced this figure by 12.4% compared with Spain's actual number of SMEs.

Considering the latest data provided by the Spanish Ministry of Industry, Commerce and Tourism for Industry and Small and Medium-Sized Enterprises (n.d.) for November 2021, the number of SMEs in Spain was 2,923,452. This shows that the pandemic hit the SMEs hard. In addition to benefiting the country through added economic growth, they also provide jobs (Lybaert, 1998). In 2021, the unemployment rate in Spain was persistently high. According to the INE (2021), Spain's unemployment rate declined to 15.98% in the first quarter of 2021. One option for new jobs is to start new companies, and unlike a large incumbent firm, a start-up can often pivot quickly to provide the most in-demand products and services.



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One crucial aspect that can benefit SMEs is internationalization and engagement into international trade. Through exports companies can generate higher revenues and become more competitive in today's highly demanding business environment although it is associated with risks. However, the number of Spanish SMEs engaged in exports remains low. Therefore, there is a need to investigate the dynamics of Spanish companies going global and factors that stimulate and hinder such a process.

1. LITERATURE REVIEW

Globalization does not only refer to the economy; for example, information technologies play a vital role in world networks, including social, cultural, and political (Jarzabkowski & Balogun, 2009). International business is affected by artificial barriers, tariffs, transport costs, and other natural difficulties such as communication and culture (Tell, 2012; Dunning, 1993). For a company that is not very, or not at all, open to the outside world but seeks to move from one country to another, the idea is to start an evaluation of one regional economic potential (Malnight, 1995). This involves adapting a company's offer and procurement (Andersen, 2004). Small and medium enterprises (SMEs) have less than 250 employees (Hunjra, 2011).

The literature review still prioritizes the structure and the background of companies as a variable that explains the complex process of internationalization, productivity, economic growth, exporting activities, net income, and employment (Benavente, 2006; Benavente & Lauterbach, 2008; Álvarez et al., 2011; Álvarez et al., 2015). There is a direct relationship between firm experience and economic growth rather than the magnitude and economic development (Haltiwanger et al., 2017; Coad et al., 2016; Kantis et al., 2016; Santi & Santoleri, 2017).

According to Oyedijo (2012) and Hollebeek and Macky (2019), strategy can be defined as reactivity when companies face changes in a new environment. Internationalization is a major risk of uncertain activity with highly differentiated returns depending on the types of investment (Coad & Rao, 2008; Goedhuys & Sleuwaegen, 2016; Hölzl, 2009; Falk, 2012; Colombelli et al., 2013; Bartelsman et al., 2015; Mazzucato & Parris, 2015; Capasso et al., 2015; Bianchini et al., 2016; Dun, 2003). With the emergence of the new economy, the impact of information and communications technology is

essential (Sultan, 2007). For the global information technology market to make dynamic changes, managers emphasize reviewing operating results to achieve their goals (Jeronimo & Medeiros, 2012). Thus, technological renewals frequently ensure market share even under challenging sectors (Entrialgo, 2002).

Globalization is a necessity for all economies, including Spain: its role is to merge these economies and create a single environment with the same advantages and disadvantages (Segaro, 2012). Spanish SMEs can be an economic and employment power, especially after the COVID-19 pandemic. As of 2020, sanitary restrictions still heavily affect sectors, regions, and markets (Manta, 2020). The complete lockdown and the COVID-19 pandemic have strengthened world business rules and the consumption vision. Much depends on local market conditions and the Spanish government's response, which considered the SMEs' immediate survival and longer-term strength. An empirical vision for this analysis is possible following this economic and theoretical background.

International organization bodies (UNWTO, 2020) encourage and promote the creation of new marketing strategies. Cooperation between all market players is possible only when there is a clear understanding and consensus (Jarzabkowski & Balogun, 2009). SMEs should use their resource to get and keep the high level of competitiveness (Kraja & Osmani, 2013). Nevertheless, participating in international activities is still very advantageous, as the geographical position of European small and medium-sized enterprises is ideal for foreign trade.

Before doing international business, it is appropriate to study strategic orientations. It indicates how close and ready a company is to compete in a global market. Firms should direct their activities toward global orientation, and by doing so, they minimize the risk. Inside the complex

internationalization process, the global competition involves companies that combine volume strategies and cost competitiveness domination (Kristiansen, 2002). For these companies, the offer is standardized, and the geographical distribution coverage of the product is at its maximum. The main characteristics of global activities are based on two things: the nature of the products, i.e., standardized products with wide distribution, and the extent of the resources used, including financial, industrial, and marketing resources.

According to long-term internationalized SMEs, exports are potent levers. In general terms, SMEs are optimistic when they think about the future. They foresee that the recovery will begin between the end of 2021 and the first half of 2022 according to the strategic consultancy TACTIO (2021). Today in 2023, companies need to make sure that the economy is recovering, even if there is still an obligation to act more prudently. These perspectives match the report “Pulse of the Spanish medium-sized company” by the consultant Grant Thornton (2022), which indicates that Spanish medium-sized companies have returned to economic growth and profit and income perspectives, similar to the pre-COVID-19 years, even above the European and world average. Two main categories of motivation can be highlighted in this report. Either it is a question of asserting Spanish SMEs in their skills and competitive advantages across borders or compensating for a saturated or becoming-saturated domestic market.

Firms that benefit from a location advantage in the country of origin are more likely to start multi-nationalizing (Cuervo-Cazurra, 2007). The first set of incentives or triggers related to the specific benefit is directly related to the desire to preserve and enhance the benefits acquired during the domestic expansion of SMEs. For sectors where marketing-mixing techniques are evolving rapidly, there is a need to develop a monitoring system, particularly to maintain a market lead. In this case, innovation is a trigger mainly for service activities. Conversely, for sectors where obsolescence is less rapid, the requirement to develop a monitoring system and create one is less critical, but this does not mean it should not exist (Dunning, 1995).

Spanish SMEs need to reduce the risks of saturation of the domestic market or a decline in domestic demand. The following sectors do not always follow the conventional internationalization stage: mobile telephony, electrical devices, construction, automotive, agri-foods, and clothing. Among these sectors, several factors are likely to generate threats: demographic changes, large volumes of investment in the short term, pressure from substitute products, improvements in living conditions, consumption habits, and product obsolescence. It is necessary to recommend and understand that internationalization is the best way to increase SMEs' net income to better understand these challenges for Spanish SMEs' survival and contribute toward their boost and recovery (Amoah-Mensah, 2013). The revision of the business model is crucial, first, because the analysis of reality needs to be based on a theoretical perspective; and second, because the reality of development is so complex and dynamic that a single theory can hardly resolve all the questions about internationalization (Andersen, 1997; Doh, 2005).

This paper focuses on the current development and prospects of the Spanish SME's potential for internationalization. The global weight is considerable, and companies in Spain are the economy's main engine, as they constitute the country's business fabric. They account for over 99% of companies and generate more than 90% of employment. Therefore, this study aims to fully appreciate and comprehend Spain's international business structure and dynamics, risks that can impede exporting activities, and factors that can boost Spanish SMEs in entering foreign markets. It seeks a deeper understanding and a better picture of the exporting SMEs figures that lead Spanish SMEs through complex internationalization.

2. METHODOLOGY

This study uses empirical analysis and develops a model with data from the Spanish Sub-directorate General for Support to SMEs (SSGS) as it publishes monthly and yearly statistics and reports. The analysis was conducted with the compilation of basic information. After care-

fully considering all the relevant facts and data, a table methodology was chosen to expose and disseminate the most relevant figures and indicators. The study assesses the current status of Spanish SMEs. In each country, competitive entry and exit exporting establishments imply that a set of changing and evolving conditions must be defined. Based on the annual indicators, a portrait of the internationalized SMEs can be defined successfully. Spanish business structure moves around a set of selected information, and this study is quantified and carried out following these seven parameters:

- number of companies;
- sectors;
- company registrations and deregistration;
- volume of revenue;
- foreign tariffs and taxes;
- company typology by legal status;
- companies by the autonomous community.

In this trade activity and internationalization process, it is essential to state that an SME must pay a high initial entry cost to enter the foreign market. Since the trade costs depend on the export status, a company can export in the long term. The definition of export activities intensity is expressed as (International activities intensity) = (Investment / sales).

3. RESULTS

Tables 1-5 present the results that answer the aim of the study, i.e., highlight the sectors where SMEs operate, company size breakdown, dynamics in the number of SMEs in 2021 and 2022, share of Spanish companies working on the foreign markets, and number of companies that invest into R&D activities to obtain a competitive advantage and access international trade.

According to Figure 1, Spain has 2,923,452 companies, of which 99.82 % are SMEs. Most SMEs in Spain are without stable employees, representing 1,606,466 enterprises and 54.95% of the total SMEs. Nonemployees status is a direct way to describe the people whose labor contributes to the SMEs but who do not work for the company. Those workers are independent contractors and consultants. The high percentage of nonemployees is not good because the need to respond to the foreign threat in the short, medium, or long term is a concern. Creating new companies, creating new jobs, and integrating innovation are necessary and considered a trigger mainly for service activities. This is reason enough to include the weight given to the international dimension. Conversely, the requirement to develop a business structure and create one is less critical for sectors where competition is less rapid, but it still exists.

Table 1. Sector breakdown of Spanish SMEs

Source: Spanish Ministry of Industry, Commerce and Tourism (n.d.).

Services		Construction		Agriculture		Industry	
73.25%	2,101,725 companies	11.33%	310,471 companies	9.43%	274,864 companies	5.99%	174,577 companies

Table 2. Distribution of employment by firm size

Source: Spanish Ministry of Industry, Commerce and Tourism (n.d.).

Micro (1-9 employees)	Small (10-49 employees)	Medium (50-249 employees)
3,370,757 employees	3,014,530 employees	2,446,382 employees

Table 3. Number of SMEs in Spain from 2021 to 2022

Source: Spanish Ministry of Industry, Commerce and Tourism (n.d.).

Year	N of firms	% of firms
2021	2,928,418	100%
2022	2,923,452	-0.17%
Difference	-4,966	-

Table 4. Percentage of Spanish SMEs engaging in international trade in 2022

Category	N of firms	% of firms
Engaging firms	160,188	5.48%
Non-engaging firms	2,763,264	94.52%
Total	2,923,452	100%

Table 5. Percentage of Spanish SMEs investing in international market R&D

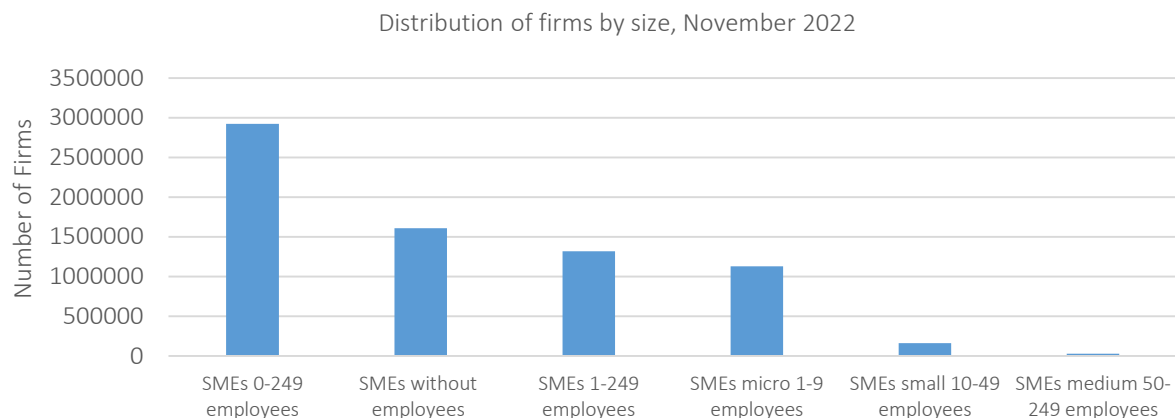
Category	N of firms	% of firms
Investing firms	13,000	8.13%
Non-investing firms	147,188	91.9%
Total	160,188	100%

Regarding employees, most small and medium-sized enterprises are micro, with less than ten workers (Figure 2). Although the growth experienced by firms in Spain and their leading role, this group is the one that experiences the most significant increase, both in the number of companies and in terms of employment. To survive, many of these firms depend on large firms in the most critical industrial sectors, and some depend heavily on the health of the national economy and individual wealth. However, those micro companies need more funds for export, internationalization, or to speed up products to the international market.

This paper studies the capacity of internationalization in a middle-income country, where export takes place only with a small part of the total number of SMEs, and the idea of working with a more significant number of employees only sometimes leads to internationalization. There are, however, two weaknesses that should be kept in mind. The first is that numbers can be manipulated to

show different pictures regarding the distribution of Spanish firms. On the other hand, this study considers a particular concept using scientific methods to prove that a more significant business means larger profits. Figure 2 shows the reality and the problem of the very meager numbers of Spanish small, medium, or large companies. These results show that the country can boost its economic growth if SMEs choose to access international markets.

The net income measures a company's profitability. This income represents the total amount of money the firm earned minus all the expenses, taxes, and interest. According to Figure 3, SMEs with no employees make up 54.95% and are the lowest income earners; they receive less than 2.0 million euros per year in sales. Micro firms tend to gain less than 10.0 million euros annually in sales. Consequently, 99.1 % of the SMEs in Spain are characterized by receiving less than 50.0 million euros in revenue per year. The findings show

**Figure 1.** Number of SMEs by employee number

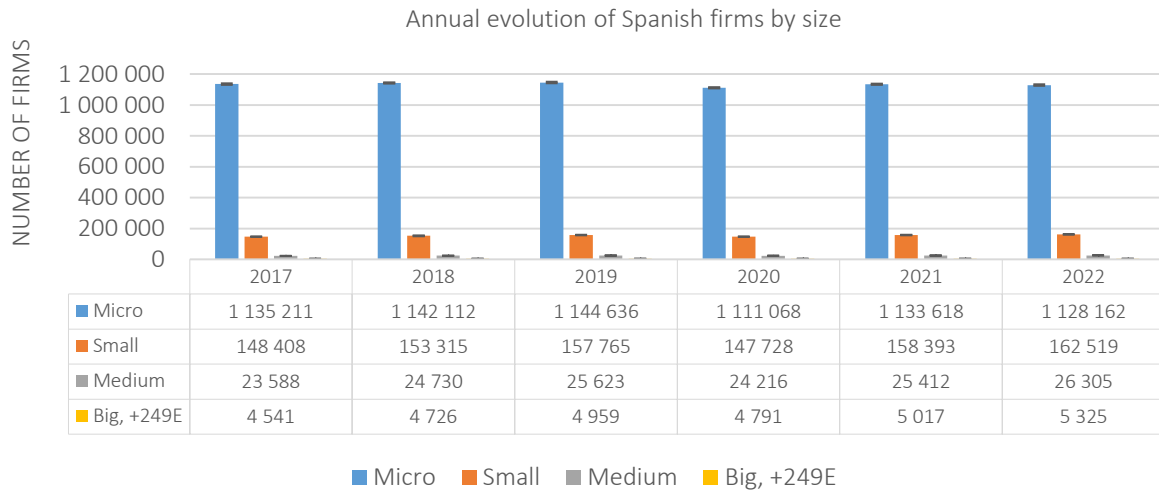


Figure 2. Evolution of Spanish firms by size from 2017 to 2022

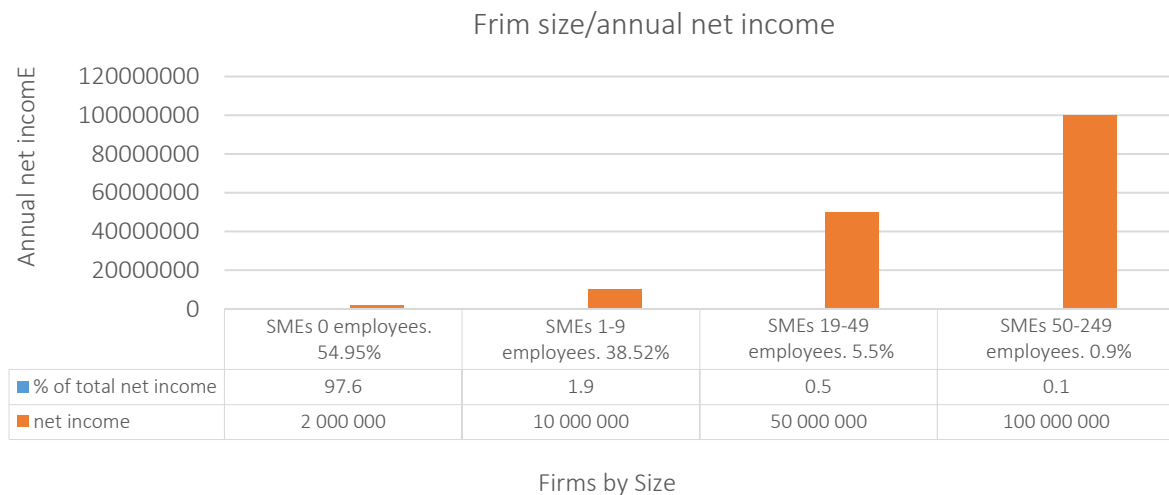


Figure 3. SMEs' size against annual net income

that very few Spanish firms create a significant annual income. Only 0.9% of Spanish SMEs (50-249 employees) generate at least 100,000,000 euros annually.

Small and medium enterprises in the manufacturing sector significantly contribute to economic growth. The two-year emergency pandemic package of increased income assistance for unstable-income households, hiring subsidies, and measures to support public investment and provide liquidity to struggling businesses was welcomed. The economic importance of SMEs in Spain is significant, and the Spanish government has several aid programs for SMEs. According to the results, full support, especially financial support, is good guidance and instruction (Andrews, 2011).

Spanish SMEs must look abroad; Figure 4 clearly shows that for a total of 2,763,264 firms, there are only 160,000 companies that target foreign markets. Only 5.48% of Spanish SMEs are involved in international R&D and invest in various forms of internationalization. Considering that all SMEs are concerned with globalization, the low-investment anomaly is a worry. Their priorities should be the same as those of large companies: to find their place in the worldwide market. Considering the insignificant percentage of the Spanish SMES engaging in a complex internalization process, the board of directors and top management should invest in international R&D and try diversification. As soon as they have the opportunity, firms should try the cross-border adventure and quickly tackle sectors on other continents.

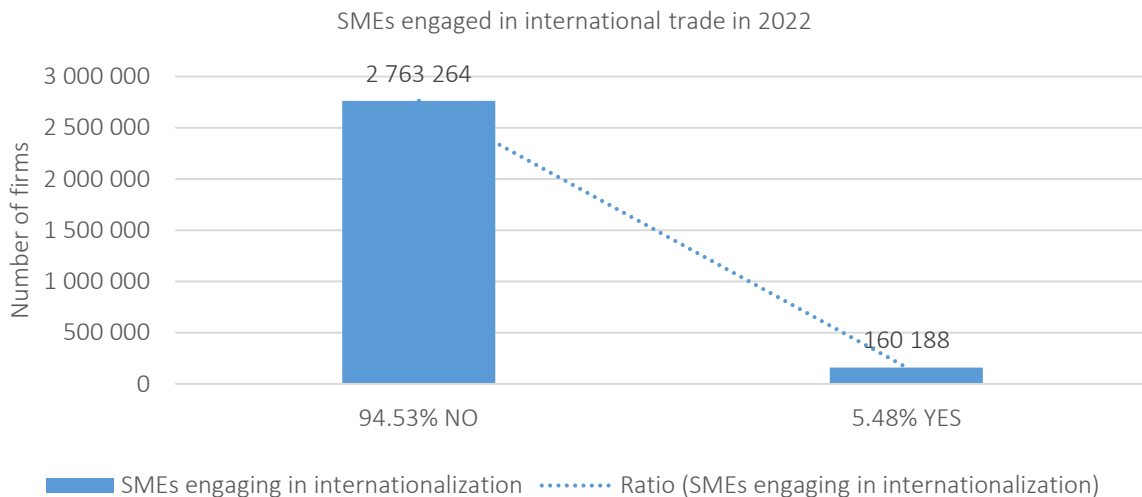


Figure 4. Number of Spanish SMEs engaged in international trade in 2022

Small companies are also subject to several risks, such as product inadequacy and organizational complexities due to the increase in size. Currency risk, the competence of local employees, and social risks of labor protection are other risks that SMEs must endure. The list continues with the financial risk of failed investments, difficulties in obtaining credit, and intercultural risk. To reduce risk, a company should prepare a checklist (see Table 6) and a short list of elements to understand the potential of internationalization. Nevertheless, risks should always be documented and communicated through a risk register in enterprise resource planning (Zhang et al., 2005). All the firms, especially the small ones that can adapt to new forms of internationalization, can control the risks better and enjoy the effects of globalization (Terziovski, 2010).

leads to local development and multi-nationalization (the international market research → development → internationalization sequence). Organization strategies, however, are highly positively correlated with the performance of SMEs.

When doing business globally, firms conduct a functional heuristic approach to examining possible and new internationalization projects. This model of economic upgrading is not typical for middle-income economies like Spain. Initial internationalization

Considering internationalization, it is essential to understand the three lines of international development. The initial internationalization is the first phase of a cautious and exploratory approach. During this phase, the parties and project managers get to know the targeted geographical location. The main objective is to assess the potential of local markets. After a good reading of the market, a company commits itself in ways that do not involve much: it can go back at any time without incurring high costs. After a year or more, this preparatory phase leads to a total withdrawal from the market or a more significant commitment, such as establishing an ethnocentric subsidiary.

In this way, the head office proceeds toward the second local development stage. This stage is a sec-

Table 6. SMEs’ self-audit to prepare for internationalization

Firm structure	<input type="checkbox"/> To know how to improve the integration of different departments in a company. <input type="checkbox"/> To understand the importance of digitalization for the international development of business. <input type="checkbox"/> To have researched the markets to be more competitive.
International business plan	<input type="checkbox"/> To research the market with statistics and other data from national and international institutions. <input type="checkbox"/> To proactively work on an export plan, not just respond to demand. <input type="checkbox"/> To prepare in advance for participation in trade fairs to optimize results. <input type="checkbox"/> To have gathered enough information to start designing internationalization plan.
Treasury and finance potential	<input type="checkbox"/> The business has an automatic billing and collection process. <input type="checkbox"/> To know the barriers to foreign trade.
Firm logistics	<input type="checkbox"/> To research options and suppliers for transportation, customs, and logistics.

ond phase that solidifies the promising nature of the project or initial idea. A company can build its business alone or create a partnership. This second step enables companies to optimize the different facets of their marketing mix. This implies the development of a particular local adaptation of the product and its strategy, which is to remove the foreign aspect of the product. Multi-nationalization is a final period of commercial development that requires many local establishments. It should no longer be considered an isolated group but a homogeneous one. This third level includes harmonizing procedures and centralizing certain functions, particularly finance. If properly conducted, this third stage can lead to globalization. The management of activities must be coordinated and integrated to achieve economic efficiency. The upstream and downstream logistics functions should be geographically fragmented, while the R&D, purchasing, and finance functions centralized at the head office. To achieve success, SMEs should constantly improve their performance, motivate and train their employees, introduce innovations, promote friendly atmosphere between customers and employees, and work on the competencies of their managers (Gadenne & Sharma, 2009).

4. DISCUSSION

This paper builds a complete profile of Spanish companies engaged in international trade and identifies the essential and required elements to understand the complex process of internationalization (Hunjra, 2011). It examines the objective of entrepreneurs and their strategic plan in export development when dealing with internationalization in business. The results show that internationalization success is more significant when Spanish companies invest in R&D activities to find the best strategies to enter foreign markets.

The pandemic forced Spanish SMEs to change their business model to keep their business running. The main challenges they faced were innovation and digital transformation. SMEs were aware of this; it was reflected in the First Barometer on Innovation by the consulting firm Leyton (2021), with 86% of SMEs considering that innovation was the best option to overcome the pandemic

crisis. Musaraj (2012) mentioned increasing differentiation from the competition: 63% saw the way out in e-commerce, and 49% of SMEs believed that the best way out was to increase international investment in marketing combined with innovation. For their part, 76% of SMEs focused on changes through new internationalization strategies. A company becomes competitive through innovation, and R&D creates more modern products and better business perspectives. Due to their high percentage, SMEs were the most affected by the COVID-19 pandemic. Aid to SMEs due to the pandemic was controversial, reflected in the opinion of companies and the self-employed.

Most SMEs were aware of all the aid and subsidies offered by the government; however, the reality is now different. Even though most businesses wanted to apply for financial assistance, they could not. The approach to managing the pandemic could have been better, and coupled with bureaucracy and stringent requirements, many companies needed more financial assistance. Those who could benefit from government aid had to face a slow process, which took months. In fact, according to statements by Cepyme and ATA, “a real rescue of Spain’s productive fabric is needed” since one in three companies could not apply for aid because they did not meet the requirements.

The results show that internationalization for Spanish SMEs is conceivable, for example, because logistics expenditures have decrease due to implemented innovative approaches and higher effectiveness of transport infrastructure. Second, the existence of international trade unions and interest in internationalization stimulate companies going global. Third, companies enjoy flexible and globalized trade connections that make it easy to sell products and services. A company becomes competitive on the foreign market through innovation, and R&D creates more modern products and better business perspectives.

Internationalization is correlated with essential fixed costs, and before expanding a company overseas, one should be aware of the additional risks of the foreign trade market. Central to this analysis, the transition for companies is partly accomplished through the rapid deployment of new organizational forms and new technologies

in production. If a company is confident of getting involved in the market, it should not hesitate to invest in resources and human capital. These results are sensitive, but international investigation is an essential point in the activities of Spanish SMEs, trying to understand why companies engage in international business while other companies lie back.

Small companies must gain the knowledge, experience, and financial support to become successful international firms. Because of their small size, managers are more focused on economic growth and market survival. The objectives of business leaders should result in more profits by pushing back the borders of the world. Companies make choices to reduce production costs and country

relocation to generate better profit margins while lowering fixed costs. The challenge for Spanish SMEs is to maintain a place in the market, but entrepreneurs need to follow the trend of globalization that aims to accelerate company growth.

Future studies can discuss obtained results from different angles. Using a larger panel of previous studies regarding SMEs would be ideal. Further research can compare data with research exclusively focused on internationalization. The data available suffer significant volatility, so it is essential to get data from the current year and the past two years. Continued support for businesses seems a suitable recommendation, especially for the smallest companies and the companies without stable employees.

CONCLUSION

This study aims to analyze the dynamics of Spanish companies exporting their services and products abroad in the services, construction, agriculture, and industry sectors. SMEs in Spain engage in export activities, but the number of international partners and countries is deficient. Less than 6% of Spanish SMEs participate in international trade. Consequently, the percentage of SMEs engaging in foreign operations is statistically insignificant to improve predictive performance.

The results showed that SMEs engaging in internationalization have better sales performance than those not engaging in international affairs. Without international trade, sales results could be critical, and one of the options is the creation of global establishments and subsidiaries with aggregate productivity. Indeed, the most financially developed companies in Europe are also those with high rates of internationalization activities.

Another result is the fluctuations in the number of exporters in Spain and the critical role of international trade in the entry dynamics. Internationalization is completed only when companies are financially and legally involved in various international activities, i.e., autonomous subsidiaries or joint ventures. An SME with one specific international operation in one year cannot be considered internationalized and cannot be compared with an SME fully cooperating with international partners and customers in the long term. A company needs to analyze the economic consequences of the progression of a certain number of its activities toward globalization. The lack of Spanish SMEs' international economic integration is due to their global marketing misconceptions and misunderstandings. Regarding basic strategies, logistics, marketing, business development, or sales, companies should be bold in establishing their role, authority, and strategic value abroad.

AUTHOR CONTRIBUTIONS

Conceptualization: Geoffrey Ditta.

Data curation: Geoffrey Ditta.

Formal analysis: Geoffrey Ditta.

Investigation: Geoffrey Ditta.

Methodology: Geoffrey Ditta.
Project administration: Geoffrey Ditta.
Supervision: Geoffrey Ditta.
Validation: Geoffrey Ditta.
Visualization: Geoffrey Ditta.
Writing – original draft: Geoffrey Ditta.
Writing – review & editing: Geoffrey Ditta.

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