



Global SMEs' Strategy

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In developed countries the number of SMEs vastly exceeds the number of MNCs. An important share of SMEs are somehow linked to MNCs – but the impression prevails, that SMEs are in a subordinate position and certainly do not have a global strategy. We argue, however, that there should be partnership relations between MNCs and SMEs. The share of importance is conditioned by the degree, how well SMEs understand the MNCs global policy and how they support it with their activity. Through that MNCs become a part of SMEs' global strategy, which consequently becomes their strategy as well. The paper includes a number of SMEs' considerations and actions to be included in the MNCs' global strategy – as well as some propositions upon public support needed for this purpose.

Keywords: outsourcing, global business strategy, small and medium sized enterprises, multinational corporations

Introduction

SMEs represent a huge economic potential. Their strength is in the number of enterprises, which is very high, in the potential to grow and prosper in the sense of creating employment opportunities, but also in the sense of creativity and innovation. Nevertheless, in quite a lot of developed and developing countries this potential remains just a potential.

For example, results of GEM (Rebernik, Tominc, & Crnogaj, 2011) show that in many European countries in the year 2010 the volume of entrepreneurial activities decreased. It seems that the most important reason for closing many enterprises has been their low profits or even losses. Besides, one of the problems of many countries, when considering the growth of SMEs, is the low growth aspirations of the active population and low internationalisation levels of SMEs as well. One of the reasons for such a situation might be the relatively low level of educational attainment in SMEs.

One of the solutions to these problems might be in linking SMEs with larger companies. The latter might act as a catalyst encouraging innovativeness of SMEs, their aspirations to grow and internationalise and to contribute as much as possible to national and international economies. Links between SMEs and larger companies might be established in different ways, but in our paper we especially consider the possibility of so-called outsourcing and offshoring. In our opinion a strategic approach to this kind of busi-

ness cooperation should be implemented in SMEs and larger companies as well. We believe that besides SMEs and larger companies, economic policy makers should be involved too. They should try to develop appropriate business frameworks, such as education and training, knowledge and technology transfer, development policy and the like.

Importance of Small and Medium Enterprises (SMEs) for National Economies

SMEs' Contribution to Economies

By definition, SMEs should be independent and not part of a larger enterprise, they should be managed in a personalized manner, and have a relatively small share of the market (Carter & Jones-Evans, 2006). There are three different SMEs categories – micro, small and medium sized enterprises differentiated by the number of employees, turnover and asset thresholds. We can talk about SMEs when at least two of the three criteria are met – there are fewer than 250 employees employed in SMEs, their turnover should not exceed 50 million EUR, and their asset value should not exceed 43 million EUR.

The analysis of the importance of SMEs operating in national and world economies (Carter & Jones-Evans, 2006; GEM, 2011) shows that the share of SMEs exceeds 99.7% of all enterprises in the majority of countries (e.g. EU, US and Japan) and that the majority of the active population (i.e. more than 50% or even 70% in the case of Europe) are employed by SMEs. In accordance with this GEM (2011) reports that in OECD countries SMEs create about two thirds of jobs.

Innovation and technological change seem to be an important factor related to the growth of the SMEs sector in recent years as well. Carter and Jones-Evans (2006) add that large companies' defragmentation, development of the service sector, changes in the labour market and public policies have been positively related with the prosperity of SMEs in recent years.

Synergies between SMEs and Large Enterprises

Nevertheless, there are some important aspects which should be mentioned when considering the positive roles of SMEs in modern economies. Namely, not all of the numerous SMEs possess high potential for creating new jobs. Research (see Carter & Jones-Evans, 2006) confirms that only a very small proportion of SMEs, the so-called 'gazelles,' significantly contributes to creating new jobs. Besides, very few SMEs grow. The overall rates of employment growth are especially low in Europe. Scarpeta, Hemmings, Tressesl, & Woo (2002), for example, showed that employment gains of US SMEs are significantly higher than those of European SMEs – their rates of growth are two times higher than the employment growth of Finnish

SMEs and four times higher than the growth of enterprises in the UK or Denmark.

It also seems that too much emphasis can perhaps be given to the conviction that SMEs represent a key source of innovation. Carter and Jones-Evans (2006) highlight some research claiming that most innovative firms in the US and Germany are not SMEs but larger enterprises, especially the ones with formal R&D departments. We believe that SMEs are often an important source of new ideas and creativity (Schumpeter, 1934), but as already said, innovation and new knowledge capitalisation is more in the domain of larger enterprises.

It seems that the power of influence of SMEs within national and international economies is lower than the influence of larger companies. Compared to large enterprises SMEs are small in size, they do not grow as much as they could, and their innovation capabilities are often weaker than expected, but on the other hand they are quite numerous and employing more people as well, when compared to the number and employment rates of larger enterprises. UNCTAD (2010), for example, reports that there are over 400 million entrepreneurs in 54 countries, but according to World Investment Report there are only 889,416 large, multinational companies (MNCs) around the world with 82,053 parent corporations and 807,363 affiliates. As one can see, the ratio between SMEs and MNCs is approximately 1:500.

Nevertheless, the practice shows high levels of interdependence between SMEs and large enterprises. European statistics show that more than 3.7 million or 7% of SMEs are suppliers to major industrial firms (EIM & Ikei, 2009) on one hand, and on the other, even 'the largest firms [...] cannot always undertake major innovations alone' (Dickson & Hadjimanolis, 1996). Innovation is a learning process which requires the exchange of knowledge and a high level of interaction and cooperation between different partners (Roelandt & Hertog, 1999).

In the studies of networking some authors focus primarily on the horizontal links and cooperation between SMEs. Marshall (1961), for example, names this type of networks industrial districts. Others highlight the links between large enterprises and their suppliers, usually SMEs (Marceau, 1999). In such cases hierarchical relationships or clusters in the vertical supply chain appear. Links may be developed between firms which need or base their business on the same resources. Furthermore, relationships emerge among enterprises involved in joint innovation or joint production (Marceau, 1999). Whittington, College, and Owen-Smith (2009) list other possible reasons for networking, e.g. the reduced costs of moving goods, increased availability of people and ideas, external economies of scale, allowing clustered firms to benefit from spill-over of knowledge, and making R&D programmes more fertile than those of their isolated competitors. Net-

working is an important factor in fostering innovation (Dickson & Hadjimanolis, 1996). Summarising some research findings, Whittington et al. (2009) note that 'there is a strong correlation between an organization's network of partnerships and its innovative output, particularly in research-intensive industries.'

Need to Support the SMEs

Governments can have a profound impact on how all firms, large and SMEs operate and on their opportunities to grow. Governments' policies in this area have become key focal points of efforts to help improve how SMEs develop and cooperate with large enterprises.

There are three main dimensions to the government role (Carter & Jones-Evans, 2006). Governments can act as regulators, as economic agents and as strategic planners and promoters. As regulators they determine trade rules, legal forms of companies, the extent of legal limits regarding company liabilities, strength of anti-trust and monopoly regulations, and influence regulation on conditions at work, consumer protection, environmental regulations, etc. As economic agents they define taxation, and influence the competitive environment by developing of government services, acting as an important employer and by introducing different social engineering and redistribution policies. As strategic planners, governments finance and support SMEs by offering grants, subsidies, loans or information and knowledge through education and training, R&D, marketing and productivity initiatives, and international trade protection and barriers.

Besides, government can significantly affect linking and cooperating initiatives between SMEs and larger enterprises. The Slovenian government, for example, puts quite a lot of effort into encouraging R&D links and training focused links between SMEs, larger enterprises, and also research organisations and higher education institutions by introducing financial incentives. From 2009 to 2015 the government plans to encourage R&D and training activities through three key mechanisms of integration (Competence Centres, Centres of Excellence and Development, Centres of Slovenian Economy) amounting to about 314 million EUR. This amount of money shows the relatively high importance of these three mechanisms, since it exceeds the volume of almost two years of regular government investment in R&D in Slovenia (Dermol & Drev, 2011).

Global Business Strategies of Multinational Companies (MNCs)

Definition of MNCs

In the paper we focus on larger companies operating in international markets. It is proper, however, to distinguish among companies concerning their strategic focus. We can identify international, transnational, global and

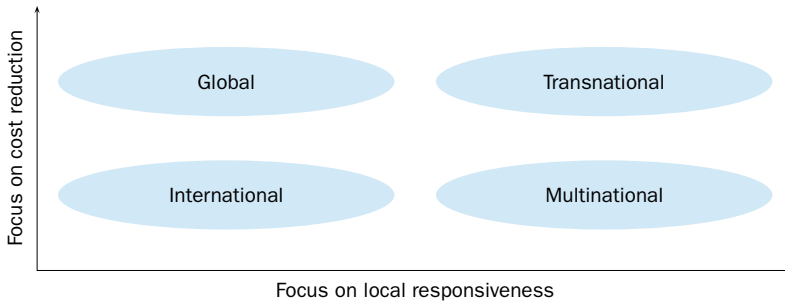


Figure 1 Types of MNCs

multinational companies. In short, international companies are exporters and importers; they have no foreign investment and make their products or services only in their home country. Transnational companies invest in many countries, may have global headquarters, but also distribute decision-making power to various national headquarters. Multinational companies, in the narrower sense, have investments only in a few countries and are more responsive to local preferences than a global company. Global companies, on the other hand, have investments in dozens of countries but maintain strong headquarters only in one, usually their home country. In this paper, however, we use the term 'multinational' for all companies operating in several or many countries (see Figure 1) (Hines, 2007).

Total revenues of the 50 largest MNCs in the world in 2010 were quite large – approximately \$850 billion (for comparison, the US federal budget for 2012 was in the amount of \$2500 billion). MNCs create and enact strategies that are best suited to their power and core capabilities, trying to think globally and operate locally (Wikipedia, 2012). MNCs' mantra is obviously economy of scale, since they prefer to homogenize products as much as the markets allow them to keep the costs as low as possible. Their marketing campaigns often span the globe with only one message (albeit in different languages) in an attempt to smooth out differences in local tastes and preferences. A crucial factor for MNCs is also the jurisdiction in the countries where they operate.

Outsourcing and Offshoring as an Opportunity for or a Threat to SMEs

Global Business Strategy can be defined as the business strategies engaged by the businesses, companies or firms operating in a global business environment and serving consumers throughout the world. Global business strategies are adopted by businesses to meet their short and long term objectives.

The short term goals of the business would be related to improving the

day-to-day operations of a company while the long term objectives are generally targeted towards improving a company's performance – to increase the profits, sales and earnings, ensuring growth and stability of the business and dominance over the national or regional market in the long run (Economy Watch, 2010). Nevertheless, the shortest way to improve company performance is to cut its costs, and this is much easier outside than inside the firm. Additionally, large companies' economics are burdened by administrative costs, internal inefficiency, cost of unionized wages etc.

Further, when considering cost structure, we assume that the share of wages substantially exceeds the cost of materials etc., especially in high-tech companies. Additionally, the wages of qualified workers and professionals – which may have ample power vs. management – can't be easily controlled. This however, is quite difficult to handle in the legal, social and economic environment of developed countries, and much easier in many less developed countries. In these countries the supply of labour by far exceeds demand. Besides, in many such countries the quality of labour and available talents in demanding disciplines (e.g. informatics) are equal to or even better than the average levels in developed countries. In addition, the cost and capacity of up-to-date communications and transport allow for high quality and low cost bridging of global distances. Due to the efforts to cut the costs, outsourcing or offshoring (which is defined as overseas outsourcing) has become an important business strategy of MNCs.

Nowadays, however, there is a passionate resistance to the offshoring strategies. Namely, many politicians and trade unions argue that they increase unemployment especially among qualified workers in high-tech industries. The protests seem to be the loudest in US, but are virtually nonexistent in Europe due to ample reserves of low-paid labour, mostly in south-eastern European countries. Garrido (2007) presents some suggestive evidence of the adverse impacts of offshoring. Namely, the AFL-CIO labour unions in USA claim that 3 million jobs were lost since 1998, and 1.78 million or 59% of them were lost due to reductions in manufacturing. The consulting firm Deloitte found out that one third of big financial institutions have transferred their operations abroad and 75% of them intend to do the same in the next two years, and the 2009 Strategic Outsourcing Conference reported a strong surge in outsourcing due to the crisis. Besides, the Forrester Research consultants predict a transition of 3.4 million 'white collar' workers offshore until 2015, Hewlett Packard announced that 800,000 workers would be moved offshore to reduce costs by about \$30 million yearly. The report of US Commerce department also notes that US MNCs have closed 2.9 million jobs in US, and have created 2–4 million jobs offshore.

Dramatic announcements abound – but beyond the criticism that MNCs,

by offshoring, diminish workplaces in USA at a cost of \$300 billion, there is another truth. Federal law allows (1) tax relief on equipment purchases connected with offshore activities (approx. \$150 million per year) and (2) payment of tax on profits delayed until repatriation. Thus the MNCs leave up to \$1 billion outside USA. This alone is a dramatic motive to increase offshoring (Rasmus, 2010).

But still, at least 90% of jobs in the US require proximity to the main companies and therefore cannot be transferred overseas (Krodel, F., Keller, A., Ratajczyk, M., & Maier, 2011). Besides, there are quite some underdeveloped areas in the US and vicinity as well (e.g. the reserves for American natives, Mexico). There can be heard voices opposed to inshore operations in the US but their potentials are limited, last but not least by traditional culture and ways of life (Jamess, 2011).

Global Business Strategies of SMEs

Concepts of Global SMEs Strategies

The power and influence of MNCs exceed as a rule the capacities of SMEs. But, SMEs are becoming increasingly a crucial factor of MNCs' performance as well. To increase flexibility and decrease costs of hierarchy, large companies strive to transfer as many activities and functions to other firms, which they control in many ways. It is possible to identify different forms of activity and function transfer reaching from outsourcing, operating contracts, to daughter firms in a corporation, cooperation, joint-ventures, etc. In all these cases, decreased costs of hierarchy are in diverse ways compensated by increasing the costs of exerting control and negotiating (Coase, 1937; Williamson 1981; Foss, 1996, 1998).

A simple and short term oriented approach is to use outsourcing to decrease costs. Namely, there are so many small firms willing to perform the same tasks for lower price. Outsourcing is then considered as a strategy following the concept of 'lean organization,' creating more value for customers with fewer resources, maximizing customer value while minimizing waste. Simplifying the concept can lead to so-called 'pragmatic outsourcing,' which means outsourcing activities to the supplier by quoting the lowest price (Krym, 2011).

This approach, however, may start a vicious circle of low prices to suppliers – barely enough for existence. Suppliers create no profit to invest in new core capabilities; they just cut wages and other expenses to the lowest possible level. As pressures on wages increase, the insourcing enterprise tries to get higher prices for the same product or service. This is not acceptable to the outsourcing enterprise, forcing it to find new insourcing partners and transfer the business to them. The previous insourcer, exhausted and under pressure to increase wages, is on the short way to bankruptcy. But,

the outsourcing party must invest to enable the new insourcer to perform according to purchasing specifications, organize logistics, introduce quality control, etc. All of these often surpass the advantage of lower price to the supplier. This process might be repeated again and again, leaving behind bankrupted SMEs and, due to the necessary investments in changing partners, negatively affecting the outsourcing party as well. For SMEs, entering the 'pragmatic insourcing' as the last and desperate attempt to survive is obviously not a viable strategy. On the other hand, larger companies need solid partners as well. In such endeavours they expect good value for money, new initiatives, ideas and capabilities from the insourcing party and not just low prices for meager services (Lean Enterprise Institute, n. d.).

It seems that the outsourcing party will invest to enhance the partnership only if it encounters a willing and understanding attitude. The initiative will, therefore, be on the side of SMEs too. They should study and evaluate possible strategies on their own, prepare and propose improvements for future cooperation with the larger enterprise and in this way try to influence the global business strategies developed by MNCs. The SMEs will therefore succeed only if they understand, at least partially, the MNCs' global business strategy and find their own position in it. On the other hand, it is possible to introduce their own strategies as well. SMEs global strategies should fit the broader strategies of MNCs and they should become an integral part of the MNCs' strategies.

There are so many successful and long-lasting partnerships among MNCs and SMEs around the world. They are, as a rule, based, on the SME's part, on creating a global – even if relatively narrow and limited – strategy, integrated in the broader strategy of the MNC partner. Then, 'small is beautiful' is a lasting qualification.

Development of the Global Business Strategy of SMEs

We can identify a series of actions which should be considered when one approaches the development of the global business strategy of SMEs:

(a) Identification of Possible Relationships between SMEs and MNCs on the Hierarchy-Market Continuum (Figure 2)

The core of business strategy of the SME is its relation to MNCs, spanning from very close to very loose ones – from so-called 'market' to 'hierarchy' concepts with many other concepts in-between these two extremes. There are different opportunities and threats hiding within the transitions among positions in the 'hierarchy' and 'market' continuum. Each possible relationship and transition among SMEs and MNCs will be carefully analysed in the process of strategy creation. Obviously, the analysis in a given relationship between an MNC and an SME can lead to various considerations.

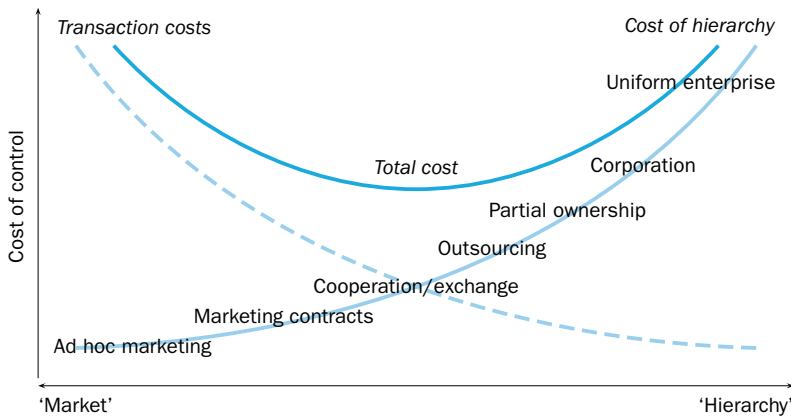


Figure 2 Hierarchy-Market Continuum

Outsourcing is not the only possible cooperative arrangement between two or more companies. Even inside of an enterprise, there are many cooperative arrangements – among functions, services, levels of management and, most important, among individuals and groups engaged in joint activities. Special cases of cooperation are corporations, possibly including numerous firms connected by capital bonds. Besides, there are different forms of cooperation, mostly bound by agreements; outsourcing is only one of many possible commercial relations formalized in sales and purchasing contracts, short or long term, fixed or variable; and furthermore licences, franchises, etc. But, not many relationships are among the equally large, powerful, popular etc. organizations. Imbalanced relations are facts of life and can be fair and open, cooperative, even friendly. If they are properly designed and based on the needs of partners, the relationships among large MNCs and small SMEs may not necessarily be unequal, tense and exploiting. Nevertheless, in spite of uneven relationships, SMEs can in some ways perform even better than the larger companies. SMEs employing just a handful of top professionals can be much more flexible and innovative than the larger ones. Relationships among small, innovative and large, powerful companies, or relationships among ‘colonizers’ and ‘consolidators’ (Markides & Geroski, 2005) may be advantageous for both sides. Colonizers develop new marketable, even revolutionary products, and sell the designs to ‘consolidators,’ which have ample financial resources, effective structures, production capabilities and access to global markets. In some cases, they even buy a ‘colonizer,’ offering good remuneration to the experts and better possibilities for R&D.

In the ‘pragmatic’ concept of outsourcing the only requirement of the outsourcing party is the lowest possible price – there is little place for a

broader cooperation – and the insourcing party must either accept the conditions or lose the customer. In creative outsourcing, the relationships and roles of the outsourcing and insourcing partner are much more balanced – oriented to lasting partnerships, negotiations are ‘win-win’ oriented.

(b) Mutual Understanding and Knowing of Business Partners

The absolute prerogative to achieve the desired outcome in a relationship between an MNC and an SME is a reasonably detailed and in-depth knowledge of each other. Oversimplified decisions related to the extent, contents, target duration and changes during relationships may cause unpleasant consequences. In extreme situations a broken relationship can be a cause for the MNCs’ costly involvement in searching, analyzing, testing and qualifying of new possible partners, and on the other hand catastrophic loss of business, followed by a long and risky recovery if not bankruptcy for more vulnerable SMEs.

(c) Recognising and Meeting the Needs and Expectations of SMEs and MNCs

As already indicated, the starting point in the process of creating an SME’s strategy should be a thorough analysis of the MNC with which the SME is going to work. This analysis should be focused on finding the MNC’s needs and expectations as well, and on creating a strategy meeting those needs and expectations. Standard managerial tools used in creating strategy will be used. The analysis of the partner’s short and long term needs and expectations may be based on the traditional SWOT model – strengths and weaknesses for the SME to meet these needs and expectations. On the other hand, an estimated SWOT will be done concerning SMEs’ evaluation of possible advantages and disadvantages of a potential relationship with the MNC. Differences among needs and expectations, time horizon of the outsourcing, joint R&D, industrial property and many others will be dealt with and resolved in integrative negotiations between the SME and MNC.

(d) Implementation of Strategic Planning Processes and Using Appropriate Planning Techniques

Strategic planning is at the core of strategic management. SMEs forced into a ‘pragmatic’ model usually do just basic planning for production. On the other hand, SMEs involved in an active relationship with their customers exercise more active planning according to their role in the mutual global strategy shared with its customers, mostly MNCs. According to the basics of strategic management, strategic planning includes (1) identification of shareholders’ expectations (based on their unstable needs and lasting values), (2) determining long term goals and short term targets to be achieved by synergistic activities, (3) structures and (4) financial as well as material

and human resources (corresponding approximately to core competencies). Strategic planning includes short term (usually annual) targets – and enables the enterprise to master steps leading to the realization of long-term goals. All of these will be sufficiently aligned with global strategy of the enterprise and in sufficient extent with the MNC's global strategy.

Setting up the goals and targets is a creative process. It can be improved by the use of the technique of creating scenarios and verifying targets and goals through comparative estimates (benchmarking).

(e) Knowing and Understanding the Cultures and Cultural Differences of MNCs and SMEs

Strategic planning in the narrower sense is more or less a deterministic activity dealing relatively little with human needs and values of employees, customers and other important stakeholders. Nevertheless, this approach is mirrored in the culture of enterprises and other organizations, as well as in their environments, and strongly influences their behaviours. Recognizing and understanding cultures are crucial abilities of managers, both in the MNCs and in the SMEs tied to them. Important authors are Hofstede (1980, 1991), writing about the culture of environments and Trompenaars and Hampden-Turner (2001), writing about the cultures of organizations. They define culture as a set of people's specific behaviours which are based on their values. We all have our own values. They might be related to personal or to organizational goals, and some of them to the ways and means of attaining these goals. Whenever people are directed in an activity which is opposed to their value, they will be reluctant and be under pressure, even hostile. Understanding the culture of an organization, be it an MNC or an SME, is a necessary condition to success. The same is valid for other organizations, groups, publics etc.

(f) Establishing the Fit between SMEs' and MNCs' Business Strategies

Furthermore, an effective strategy of SMEs in relations with MNCs must be reasonably congruent with the MNCs' global business strategy becoming the global strategy of the SMEs as well. Consequently, SMEs working with several MNCs will have even several global sub-strategies on one hand, or on the other, if feasible, a synthesis of them. This is a normal strategic behaviour not only of most SMEs but of all organizations operating in the marketing economy nowadays.

(g) Practising Learning in the Relationship between SMEs and MNCs

Last, but not least, the relationships between MNCs and connected SMEs can be an important source of knowledge creation. Learning is, by definition, a social process based on ideas and a sifting process as well. In

this way, the knowledge can be internalized by members of all involved organizations. Learning is on the other hand an absolute necessity to build new core competencies which facilitate the creation of competitive products and services, leading to organizational success. There are five strategies which could be used in this context: (1) collaboration which is highly receptive and highly transparent, (2) competition which is highly receptive and non-transparent), (3) compromise as a moderately receptive and transparent process, (4) accommodation which is non-receptive but highly transparent, and (5) avoidance which is neither receptive nor transparent (Larsson, Bengtsson, Henriksson, & Sparks, 1998).

Supporting introduction to SMEs Strategy

Governments can significantly influence the collaboration between SMEs and MNCs, encourage learning within the SMEs, and assist in the implementation of global strategic thinking. SMEs are somehow reluctant to use consulting services as well, and therefore need some kind of a push from outside. This push can come from governments offering grants, subsidies, loans, education and training, and also R&D, marketing and productivity initiatives. We have already mentioned some mechanisms which the Slovenian government is using to link SMEs and other organisations to foster training and R&D, which is actually a kind of learning or transfer of knowledge (since there are some knowledge organisations involved as well). Of course, in all of these possibilities the idea of outsourcing should be built in the future to show the SMEs that a strategic approach to MNCs might provide a good opportunity to prosper and to grow.

The educational system with entrepreneurial learning approaches is another opportunity which can be used to promote the idea of a systematic approach to outsourcing and global strategies in these areas. We have already mentioned that learning – the education and experience of entrepreneurs – is related to the performance of SMEs. Entrepreneurial learning is an issue on which many educational institutions have been focusing lately (Dermal, 2010). We are of the opinion that the knowledge about outsourcing should be considered as an important educational theme as well – especially within the context of entrepreneurial learning.

Besides, many countries including Slovenia have developed a system of SMEs' support. Such systems usually include three support environments (i. e. entrepreneurial, innovation and financial environment). The major roles of such systems are to make the administration efforts at the entrance into entrepreneurship as easy as possible, to offer the SMEs – especially high-technology ones – the best possible operating environment and infrastructure with possibilities for networking with the R&D sector, and to improve the access to finances, thus enabling the growth of SMEs. Again, we believe

that the idea of outsourcing should be built into all the mentioned support environments, and additionally, the mechanism introducing the possibilities for SMEs to get in touch with possible MNCs looking for business partners might be introduced as well.

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