Venturing beyond the backyard: Growing the family business internationally

Summary prepared for Family Business Australia (South Australian chapter) seminar

by

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Introduction

Over the last two decades, Australian Small-to-Medium-Sized Family-owned Enterprises (SMFEs) have been faced with substantial changes in their competitive environment as the Australian government has successfully negotiated Free Trade Agreements (FTAs) with other countries. The ability of the Australian economy to benefit from these agreements is dependent on SMFEs identifying opportunities and exploiting their competitive advantage in the international marketplace. However of all the businesses in Australia, of which 67 percent are family businesses, less than five percent are engaged in exporting which is well below that of most European countries and Canada. As a consequence, the purpose of this study, which was supported by Family Business Australia (SA chapter) and the Australian Research Council, was to explore three issues:

- Are SMFEs taking advantage of growth opportunities in the international marketplace?
- What factors influence the ability of SMFEs to grow internationally?
- What benefits have SMFEs experienced from international expansion?

The remainder of this document summaries the findings of these three issues and concludes with some suggestions for family business owners who are considering international expansion as a possible growth strategy for their business.

Are SMFEs taking advantage of growth opportunities in the international marketplace?

Although the Australian government has implemented a range of strategies to substantially increase the number of exporting businesses, the results of this study suggest that SMFEs face unique barriers to taking advantage of international growth opportunities. Compared to their non-family counterparts, SMFEs are less likely to venture into the international marketplace. Specifically, the proportion of SMFEs and non-SMFEs engaged in exporting was 35% and 53% respectively.

Furthermore, those SMFEs that do venture overseas, do so to a lesser degree when compared to their non-family counterparts. The proportion of sales to overseas markets by SMFEs and non-SMFEs was 5% and 9% respectively. This suggests that policy initiatives directed towards the international growth of family firms are warranted. Although there are suggestions that these findings may be limited to SMFEs in the manufacturing sector, international research suggests that family firms lag behind their non-family counterparts across a range of industries (i.e. manufacturing and non-manufacturing).

What factors influence the ability of SMFEs to grow internationally?

SMFEs are less likely to venture overseas compared to their non-family counterparts. The findings from this study suggest there are two key reasons as to why.

Firstly, with regard to a firm's vision and objectives, some family owners simply have no desire to grow the business internationally; rather, they have a strong commitment to continuing the tradition of successfully serving the domestic marketplace. Also, because family owners often pursue multiple (and sometimes competing) objectives such as firm growth but also the desire to preserve a particular lifestyle, it may be difficult for SMFEs to maintain an ongoing commitment to international growth. However, succession to the next generation can bring about a revival of an entrepreneurial spirit, where a global vision for the firm is initiated.

Secondly, because SMFEs have a preference to fund growth from retained earnings, their performance in the domestic marketplace largely determined the funds available for international expansion. Financial resources were required to fund activities such as exhibiting at international trade fairs, and to bring about the changes required within the firm (such as the expansion of their productive capacity). Therefore a lack of available financial resources was found to decrease both the propensity for and extent of international growth of SMFEs.

SMFEs that do venture overseas, do so to a lesser degree when compared to their non-family counterparts. Although SMFEs may have had an ongoing commitment to international growth, their ability to successfully grow internationally was dependent on the ability to configure their resources to create global capabilities. Production capabilities, international network relationships and overcoming a 'production mindset' to build the requisite managerial and marketing capabilities were all found to be critical to the international growth of SMFEs. Marketing capabilities were particularly important for transforming SMFEs from 'hidden champions' to high-profile international businesses.

What benefits have SMFEs experienced from international expansion?

The study's findings suggest that, compared to solely focusing on the domestic marketplace, there were financial benefits to be gained by SMFEs in venturing overseas. These included superior financial performance and higher growth rates in sales and total assets. These benefits, however, were dependent on having a long-term commitment to international growth, as well as the financial resources and managerial capabilities required for international growth.

International growth also enabled SMFEs to reduce their overall risk by decreasing their reliance on the domestic marketplace. Through the knowledge and experience gained in the international marketplace, SMFEs were able to bring about the changes required to improve their overall competitiveness. This included the development of their production and management capabilities, as well as the development of their brand image and marketing capabilities. Such changes enabled SMFEs to successfully compete with both their domestic and international competitors.

International growth, however, was found to place substantial demand on the limited financial resources of SMFEs. The financial strain was often a result of a timing issue where the investment in international growth activities preceded the realisation of international sales. Also, unless SMFEs took the necessary steps to protect the intellectual property of their products, they ran the risk of financial losses associated with unauthorised use of their designs by foreign competitors. Other negative outcomes associated with international growth included the strain placed on the family and management and conflict within the firm. The demands of international travel not only placed strain on the family managers, but also on their family members, as well as on the management of the business as a whole. Conflict often arose within SMFEs when there were family members or non-family managers who were resistant to the changes required for international growth.

Suggestions for SMFE owners who are considering venturing overseas

It is clear that international growth can bring a number of financial and non-financial benefits to an SMFE. Although family firms may benefit in the short-term from taking advantage of international opportunities as they arise (opportunistic exporters), overall the benefits from international growth accrue in the medium-to-long-term. Therefore, the family and the business must be willing to make a long-term commitment to international growth.

Because international growth is a long-term strategy, family businesses intending on venturing overseas, or aiming to increase their degree of international growth, need to engage in strategic planning. Because international growth often requires organisational change, it is essential that the family be fully aware of what is required to develop a successful internationalised family business.

Strategic planning addresses issues such as the fit between the family's aspirations, the vision and objectives of the firm and the intended international growth strategy. It is also useful for identifying the resources and capabilities that will need to be acquired or developed in order to execute the intended international growth strategy (gap analysis), how they will be obtained, and the organisational change that will need to occur to bring this about.

Through strategic planning, family members can also assess what implications international growth has on the family unit, such as the extra workload or travel commitments placed on family members, potential effects on the ownership structure, dividend policy and career development opportunities. A key part of the international growth of the firm is strategic management where the strategic plans of the firm are compared with the outcomes so that corrective actions, where necessary, can be taken. For example, strategic management is important to ensure that the risks associated with international business are spread across several markets rather than being concentrated in one geographical region. Mechanisms also need to be in place to effectively manage the conflict that can often arise from bringing about the changes required for international growth, which may include establishing an active board of directors with outside expertise, use of an advisory board and use of a family council.

The findings from the current study suggest that it is essential that the firm acquire and build the requisite resources and capabilities in order to build a successful international family business. These include:

- *Financial resources*

  Although government grants, such as the Export Market Development Grant, can be a useful source of finance (and knowledge) for family firms in the early stages of international growth, they are not sufficient to build an international family business. Unless a family firm enjoys a dominant position in the domestic marketplace, it will need to raise the necessary funds through industry grants, debt and/or equity finance. This may mean taking greater risks (higher gearing ratios) or the family relinquishing some of its control (outside equity). Failure to raise and commit sufficient financial resources to the execution of an international growth strategy may expose the family business to risks greater than that faced by domestically focused family firms.

- *Physical resources*

  Family firms need to configure the infrastructure (physical, human and organisational) to develop the production capabilities required for international growth. These include having sufficient production capacity to meet both domestic and international demand, the ability to reliable produce high quality products at a globally competitive cost, and the ability to develop innovative product lines, or adapt their existing lines, to meet the requirements of international markets. Because innovation has consistently been shown to be a key driver of international growth, it is critical that family firms develop the entrepreneurial culture that supports an ongoing commitment to innovation.

- *Human resources*

  Although they may have the technical skills, many family managers will not have the business skills required to grow the business internationally. In addition to formal training (in business management/marketing) of existing family managers, the employment of non-family managers with the necessary expertise and family business experience can be one of the most effective ways to acquire the skills for international growth. One possibility is equipping future successors with the necessary expertise through education and international business experience outside the family business. Because succession to the next generation can bring the revival of the entrepreneurial spirit required for international growth, mechanisms (such as an active independent board) should be in place to ensure a family CEO does not stay too long in the job. Not only is it important to acquire the necessary expertise, it is also important to give managers the autonomy to proactively respond to opportunities in their areas of responsibility.

- *Organisational resources*

  In order to grow the family business internationally, it is critical that they develop their international business networks and their marketing capabilities. Family manufacturing businesses are often very proficient and innovative in what they produce. The challenge they face is making the transition from a production mindset to a customer orientation. Failure to do so puts family firms at risk of remaining ‘hidden champions’: leaders in what they produce but remaining largely unknown in the international stage.

In addition to developing a family brand and providing superior customer service, it is critical that family firms develop their international business networks, which have been identified as one of the key drivers of SME international growth. Forming network relationships with overseas firms with the required 'horsepower' to grow the family firm's sales at a rate appropriate for its production capacity, is one of the most important steps that they can make to internationalise. In addition to developing a comprehensive website, exhibiting at key international trade fairs is one of the key ways a family firm can develop its international networks and build brand awareness. Because they can play an influential role, it is critically important that competent family members are willing and able to travel internationally to build such international business relationships.

As they grow internationally, it is important that family firms have the managerial capabilities to manage that growth. Through appointing additional managers, management education and adopting modern management processes, the international growth of the family firm can be effectively managed to minimise the strain placed on both the family and domestic operations, as well as releasing family members to represent the firm overseas at trade fairs. It also enables family firms to more effectively manage (and be comfortable with) the risks associated with undertaking additional debt to finance growth.

For those interested in obtaining a copy of the full report of this study [35 pages], or have enquiries relating to this study, please contact Dr. Chris Graves using the following email address: chris.graves@adelaide.edu.au

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