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High-Growth Firms in Low-Growth Regions: Internationalization as a Predictor of Growth

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Abstract: High-growth firms are receiving much attention due to their crucial importance for regional economic growth. We use theory on high-growth firms to propose internationalization as a key growth driver and examine this proposition through a survey of high-growth firms in the low-growth region of Central Catalonia. We find support for the proposition and identify competitive strategies not aligned with the strategy of internationalization. We hence identify additional growth opportunities related to branding and strategic alignment.

Key words: High-growth firms, internationalization, branding, strategic alignment, growth

INTRODUCTION

High-growth firms are a key driver of job creation and therefore a phenomenon of great interest not only to managers but also to institutions and policy makers (Nightingale and Coad, 2014). Firms that grow fast create more jobs than large firms (Birch, 1979). Most small firms do not grow so the few firms that do exhibit fast growth are responsible for a salient portion of job creation (Acs *et al*., 2008; Birch and Medoff, 1994). The interest for promoting high-growth firms is therefore increasing as made apparent by initiatives included in the Europe 2020 Strategy Report (EEA, 2010) and by OECD (2010). Research in this field is also booming which is demonstrated by several recent special issues (Audretsch *et al*., 2014; Coad *et al*., 2014).

We still know little about the determinants of high-growth firms (Coad *et al*., 2014). Research has found that high-growth firms tend to be concentrated in large, diversified, metropolitan regions. This can be explained by a bustling business environment with access to major universities and research facilities which makes companies thrive (Acs and Mueller, 2008). Regions can aim to create this type of business environments which tend to lend fertile ground for growing firms. Beneficial country financial and contractual policies have been shown to increase firm growth (Bravo-Biosca *et al*., 2013). Although, high-growth firms are relatively rare in regions that do not provide the most suitable conditions for growth, some firms grow more than others. In this study however, we ask which the determinants of high-growth are in low-growth regions. We review the relevant literature and formulate hypotheses which are then tested through a survey of high-growth firms in the region of Central Catalonia.

Strategies for high growth: Firms can grow through launching new products or through entering new markets in an internationalization process (Kylaheiko *et al*., 2011). Internationalization is a significant opportunity for growth and value creation, especially for firms that operate in small domestic economies with limited domestic markets (Buckley and Casson, 1976; Lu and Beamish, 2001). When the domestic market is small or saturated, firms can thus need to seek out other regions where the market exhibits more advantageous conditions for growth. Companies can actively seek to expand the market for their products through internationalization. Firms in low-growth regions will generally find their sales limited by the regional growth curve and are therefore well advised to internationalize. We can hence expect the degree of internationalization to be a predictor of high-growth for firms in low-growth regions. We formalize this hypothesis:

- Hypothesis 1: in low-growth regions, internationalization will be a predictor of high-growth firms

To compete in global markets, firms need to implement glocal strategies that combine the advantages of internationalization with strengths derived from the local situation. The duality of global and local factors are at the heart of the current glocalization trend (Drori *et al*.,

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2014). New technologies and the creation of strong brands enable companies to operate globally but the culture and the use of established products and services happen locally, forcing companies to use glocal strategies combining global and local aspects of the business. Ghemawat (2007) introduces three main strategies for dealing with glocalization: with the Adaptation Strategy, companies adjust to local differences through adapting their offering to local premises. The Aggregation Strategy on the other hand, suggests that companies attempt to overcome differences between countries and regions, e.g. through building global brands and standardizing products. The Arbitrage Strategy prompts companies to exploit the differences between countries, taking advantage of the differential characteristics of their home region such as a recognized gastronomic culture or access to particular raw materials. All three glocalization strategies require brand promotion to enter the international market whether it is a brand adapted to the region of sales, a global brand or a brand that promotes the benefits of the firm's home region. We can therefore hypothesize that high-growth firms in low-growth regions will use branding as a tool for internationalization.

- Hypothesis 2: in low-growth regions, high-growth firms will place emphasis on the activity of branding

MATERIALS AND METHODS

In order to validate the hypotheses, we have analyzed a set of high-growth firms in the low-growth region of Central Catalonia. The GDP growth of Catalonia has been negative during 2011-2013 and during 2014 remains below 1.5% (Idescat, 2014). The selected sample contains high-growth firms in the region of Central Catalonia including the counties of Bages, Bergueda, Cerdanya, Garrotxa, Osona, Ripolles and Solsona. The firms included in a sample have a minimum of five employees and a sales growth rate of over 6% during the period 2010-2013 as well as a Return on Assets (ROA) of over 5% during 2013. The growth rate of 6% is a comparatively low growth rate for high-growth firms and reflects the choice to analyze high-growth firms in low-growth regions. Service industries where omitted from the sample and the remaining 75 firms where distributed over manufacturing and related industries with a large share of companies (31%) belonging to the food industry. The basic materials industry was also well represented in the sample with 29% of the firms and includes materials such as metals, wood, paper, cardboard, plastics, textiles, electrical equipment and hydraulic equipment.

We sent a survey to the 75 firms in the sample, asking about key competitive factors, strategic management and investments, commercialization, markets and internationalization, innovation, quality, products and production processes, human resources and training. The survey was returned by 23 of the 75 firms which gives a response ration of 31%. The companies that responded to the study are very similar to the distribution of the full sample regarding profitability (ROA) and the number of employees. The average profitability in 2012 was 12.2% for the responding firms compared to 12.3% for the full sample. Nearly all firms in the sample are small with less than sixty employees.

RESULTS

When asked an open question about the three environmental factors with most impact on the activity of the firm, 22% of the high-growth firms mentioned internationalization. The 13% perceived internationalization as a facilitating factor whereas 9% of the companies viewed it as a limiting factor.

When prompted with another open question about the three key decisions that have led the company to its current situation, internationalization was the leading factor, mentioned by 43% of the firms. Furthermore, when asked whether the most significant market of the firm was the local, provincial, Catalan, Spanish or international market, 70% of the companies opted for the international market.

Companies derive much of their international growth outside Catalonia. The most significant market for high growth firms is undoubtedly the international market. Only 9% of the high growth companies in Catalonia named the international market as their most significant one whereas 12% indicated both the Spanish and the international market. In the study, the percentage is much higher with 70% of responses indicating the international market. The Catalan market in the study is 30 and 18% Catalonia. The exports of the surveyed firms have grown in importance in recent years as shown in Fig. 1. International exports represented 21% of sales in 2008 and 41% in 2013. Exports are directed mainly to the EU (46%) and Asian countries (30%). The results thus lend support to hypothesis 1 indicating that internationalization will be a predictor of high-growth firms in low-growth regions.

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Fig. 1: International exports of high-growth firms in low-growth regions

Whereas 43% of the surveyed firms indicate internationalization as one of the three key decisions that have led the company to its current situation, only 17% attributed the success to the marketing strategy. We find while 61% of the surveyed firms indicate that they have made changes in their promotion channels during the period 2011-2013 for only 39% of the firms the firm position has changed. The 74% of the firms engage in promotional activities and 48% of the firms promote the generic image of the company and also certain products whereas only 13% engage in brand promotion.

When asked about their key factors for competitiveness, 39% of the firms did choose marketing as one of the main factors. A quarter of the sales of the high-growth firms during 2013 come from new products. The degree of new products, however is unevenly distributed among the firms. For 32% of the firms, sales of new products reached >60% of sales. Most of the companies have made improvements in quality of products and services during the period 2011-2013 but only a 30% have created new features in products and 18% make changes in the product offering annually or more frequently.

The 30% of the companies outsourced the activity of outsourcing. The 30% of the high-growth firms have CSR policies that go beyond environmental policy (57%) or quality certifications (48%). The low use of CSR to create links to the local community and strengthen the brand of the firms is an additional indicator of the low importance that these firms place on branding and marketing (Polonsky and Jevons, 2009). The results do hence not support hypothesis 2 that high-growth firms in low-growth regions will place emphasis on branding.

DISCUSSION

The results show that high-growth firms in low-growth regions tend seek growth in international markets. These firms do however no engage in the branding effort that would be aligned with such an internationalization strategy. Given the rapid increase of the internationalization of the firms in the sample, it is understandable that some strategic aspects are lagging behind.

The absence of branding as a key strategic activity can be heralded from a limitation of the study, namely the recent data. Some effects of the rapid growth and internationalization may not yet be present. Still, the results highlight the importance of branding for high-growth firms. It is remarkable that a quarter of the surveyed firms engage in no promotional activities whatsoever and that the firms that do invest in promotion focus on the generic image of the firm or on certain products in lieu of investing in the brand. An additional limitation of the study is the small sample size which is inherent in the search for high-growth firms in regions that to not provide fertile ground for these.

Firms need to consider brand communication as an investment and not as an expense in order to convert communication in the central nervous system of the organization. Marketing is a space where communication assumes protagonism (Van Reil, 1995). One branding initiative that have come to the knowledge is the effort of some firms in the food industry to create a joint brand called Catalonia Gourmet where they pool resources to create a regional brand and piggyback on the rising popularity of the brand of Catalonia as a region.

The results also show that only a third of the firms outsourced advertising. This could be due to that the activity is carried out internally but more probably is the result of deciding to maintain a low profile in media. The current marketing strategy is a reflection of the small size of these firms and their local history where the relation between corporate identity and corporate image is key for social recognition. The rapid internationalization is posing new challenges for these firms and new technology allows for new opportunities to organize marketing more efficiently, e.g., through online marketing models.

CONCLUSION

We have identified internationalization as a predictor of high-growth firms in low-growth regions and suggest additional growth opportunities through the alignment of strategy and enforced brand promotion.

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