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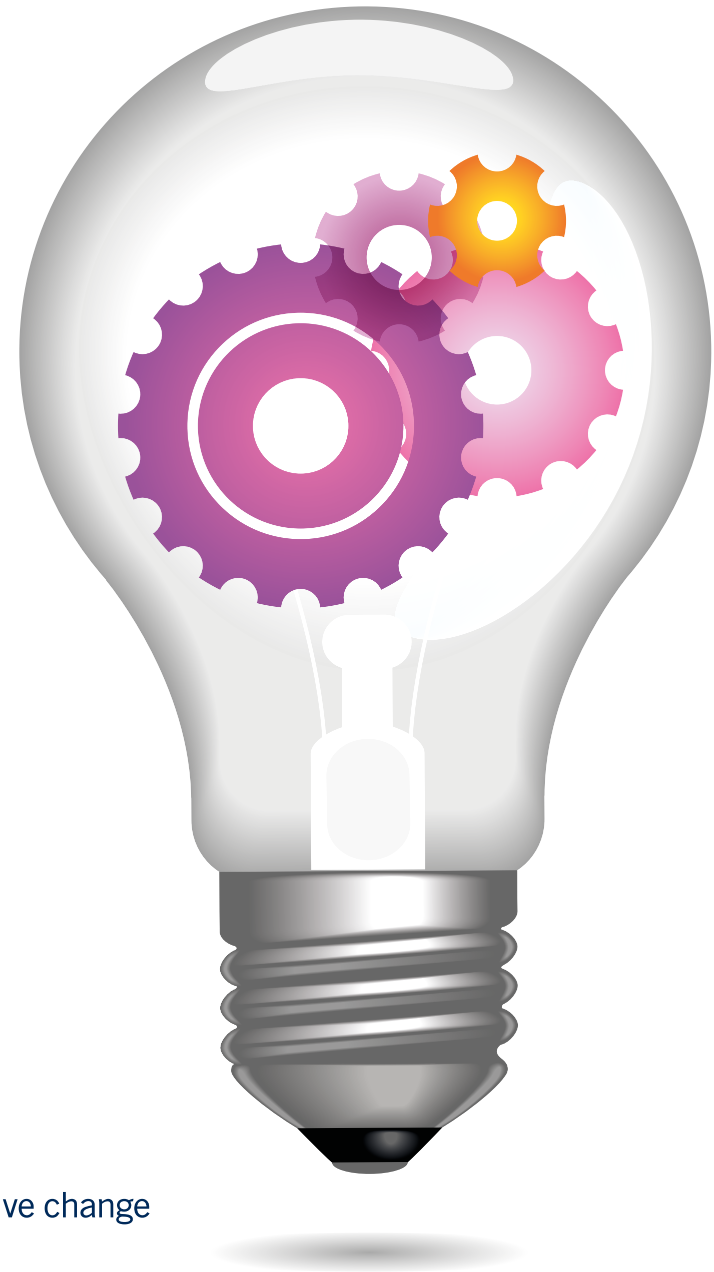

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How big should a young firm think?

By ***Giuseppe Criaco***

These days, more and more companies are "born global" – that is, instead of starting out thinking of their market as merely their city or their country, they look at the whole world and see potential customers everywhere.

The nature of the internet and modern digital communications is driving many global business dreams these days, but many ambitious people in smaller economies, such as Sweden, have always thought this way. In fact, businesses often had no choice: after all, how many of your products can a small market of 10 million Swedes buy?

In Sweden, if you wanted to build any real sustained competitive advantage, sooner or later, you had to think about markets beyond your borders. From ABBA to Volvo, the most successful Swedish brands have focused on exports.

Considered as a way to diversify risk, an export strategy makes logical sense for young firms, but what kind of international strategy? On the one hand, the kind of textbook step-by-step intraregional geographic diversification strategy (concentrating in a region and expanding within that region) most managers learn at business school has a high opportunity cost.

On the other hand, taking on too much at once (by spreading across different regions or pursuing an interregional geographic diversification strategy) can easily spread a new company's resources too thin and lead to failure. Are you better off, then, concentrating on different countries within a single region or pursuing multiple regions simultaneously?

As someone who did his graduate work in Sweden and is a specialist in entrepreneurship, I thought Swedish start-ups would be a good population to study for an answer to this question. Most Swedish companies are born thinking of cross-border sales, and the business culture as a whole is quite adept at global business. Whether the company is Ericsson or Spotify, Swedish multinational companies have historically suffered relatively few of the kind of cultural problems that companies from larger countries deal with as they went global.

Tracking start-ups

To find out whether there is a simple rule about the relative value of pursuing an intraregional versus interregional strategy, my colleagues Pankaj C. Patel from Villanova University, Lucia Naldi from Jönköping University, and I examined the track record of 680 Swedish born-global start-ups founded in 2002, 2003, or 2004 in the manufacturing industry and followed their survival up to 2010.

When we examined how they had performed, we found companies that pursued an intraregional geographic diversification strategy tended to fare better than those who diversified broadly globally. Our models showed that intraregional diversification – broad expansion within a region – lowers the risk of failure, while interregional diversification – broad expansion across different regions – increases the risk of failure.

This was true whether the market at home was volatile or offered steady profits. If the home market is very dynamic, it demands greater managerial attention than if business conditions were a little sleepier. More attention paired with broad expansion within a region allows for cost control by lowering costs of understanding export requirements, transportation costs, and logistics costs in related markets within a region, further reducing the risk of failure.

On the other hand, if the home market is more predictably profitable, young firms may go abroad with somewhat deeper pockets, which could compensate for some missteps derived from broad expansion across different regions. Yet our results showed the opposite: young firms that launched in a favourable home market and still undertook interregional diversification were more likely to fail. In either case, those born-global start-ups that survived tended to be those that pursued an intraregional internationalization strategy.

Safety first

This might seem somewhat counter-intuitive in the case of the company that is beginning with a favourable home market. After all, if your local industry provides enough resources to support you and to enable you to grow and prosper, why wouldn't a broader, more aggressive expansion make sense? The reason is that the limiting factor is not cash but execution risk. A relatively small, young firm that expands too far and too fast is likely to run into difficulties in trying to manage all those far-flung outposts.

We think there are several reasons this may be the case. For instance, it's harder to serve dispersed customers at long distance, both for reasons of logistics and market knowledge. On the other hand, shipping to a single region reduces transportation and distribution costs within the countries in that region and improves the return on marketing expenses. Concentrating limited resources on distribution and promotion enables the born-global to realize a higher return. In cases where goods must sometimes be returned, consolidation and proximity may also help reduce distribution costs.

> *"A relatively small, young firm that expands too far and too fast is likely to run into difficulties..."*

Our research does not establish whether this is equally true for non-manufacturing firms. Software and other virtual goods may well behave somewhat differently. However, although they will have fewer logistical headaches, other problems such as regulation and customer knowledge will remain a matter of concern.

This conclusion may seem counter-intuitive in an age of instant global communication and artificial intelligence, but in the end, businesses are still run by people, and people still have a limited amount of time and energy. ■

This article draws its inspiration from the paper *Geographic Diversification and Survival of Born-Globals* written by Pankaj C. Patel, Giuseppe Criaco and Lucia Naldi and published in the *Journal of Management*, Vol. 44, No. 5, May 2018. DOI: https://doi.org/10.1177/0149206316635251

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