THE IMPORTANCE OF LEGAL ORGANISATION OF RAPIDLY GROWING COMPANIES FOR INTERNATIONAL BUSINESS COMPETITIVENESS

Riko Novak¹, Viljem Pšeničny²

Abstract
This article discusses the importance of a company’s legal form for the process of internationalisation using a sample of 1577 Slovenian companies. We refer to previous studies and on the basis of additional statistical data evaluate whether the choice of corporate legal structure influences a company’s ability to compete internationally. In the domestic market, most companies operate as limited liability companies; this is also the most frequent legal form in which companies enter foreign markets. We conclude that the form by itself does not influence the decision to go international.

Key words: dynamic companies, dynamic entrepreneurship, internationalisation, legal form

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**Introduction**

In this article we discuss the importance of a company’s legal organisation to its ability to compete internationally with a focus on Slovene companies and their responses to certain key factors in the internal and external business environment. Rapid growth is a key element if companies wish to be competitive, and we will examine how the legal status of a company affects its ability to grow.

In the literature, different terms are used to describe fast-growing companies, such as gazelles, rapidly growing enterprises, dynamic enterprises, and enterprises with potential for growth. We will use the term dynamic companies (Birch, 1987; Kingstone, 1987; Davidsson, 1989; Mei-Pochtler, 1999; Pšeničny, 2002). Generally speaking, these are small and relatively young companies that experienced rapid growth (adapted from Henrekson and Johansson, 2009). According to Pšeničny (2002), such companies appear on the market suddenly, obtain the resources necessary for growth (employees, knowledge, and funds), develop or grow rapidly, and achieve above average growth in a relatively short period of time, a maximum of five years. Some authors such as Acs and Storey (2004), Acs and Amoros (2008), Acs and Mueller (2008), Acs et al. (2008) have provided the following definition of dynamic companies: these are high-tech, innovative, fast-growing companies which appear on the market with a new product or service, obtain financial resources, start doing business seriously, then grow swiftly and attain better than average results in their field.

In Slovenia, research on fast-growing companies and dynamic entrepreneurship is a new field. Companies can be evaluated only on the basis of monitoring of data and information about the companies and entrepreneurs over several years, and not on the basis of initial successful business operations. Research has therefore focused on companies with fast growth during the twenty year period from 1992 to 2012; most of these companies experienced dynamic growth over a five-year period (Žižek and Liechtenstein, 1994; Mei-Pochtler, 1999; Roure, 1999). In Slovenia, the newspaper Dnevnik has published an annual list of the “500 fastest growing companies in Slovenia” for several years. Only recently have Slovenian companies that can be described as international been given close attention, and the differences and similarities between dynamic entrepreneurs in Slovenia and the rest of the world and their potential for international business operations been analysed (Hisrich and Drnovšek, 2002). We will now consider whether the selection of the legal form of a company’s organization has an impact on successful internationalisation or its further transformation for successful international business operations. We will see how many
successful Slovene companies decided to enter foreign markets and in which legal form.

**Theoretical Background**

**Definition of a Dynamic Company**

Successful companies grow rapidly, hire new employees intensively and are always a step ahead of the competition. Part of this success depends on the company’s ability to internationalise its business operations. For a company to succeed, the following factors are essential: 1 – sufficient funding for rapid growth; 2 – finding the right people for new assignments in the company; 3 – plans for expansion and seeking new markets (internationalisation). In today’s economic climate, these are most often small, high-tech companies which have the ability to identify new market niches and adapt their business models to mastering new market opportunities; such companies are the main driving force of the economy (Birch, 1987; Kirchhoff, 1994; Henrekson and Johansson, 2009). In general, around 85% of economic growth and of all new jobs are created by 5% of business entities (Birch, 1987). According to Henrekson and Johansson (2009), dynamic companies are responsible for the creation of more than 40% of all new jobs worldwide (there are similar statistics for the Slovene economy in Pšeničny et al., 2012) and are an important driving force in regional development, despite the fact that they represent only 2 to 10% of small and medium sized enterprises. In general, it can be said that in business, the size of the company is not as important as its age. However, size and age are two of the most important factors in determining how quickly a dynamic company will grow (Armington and Acs, 2004; Fritsch and Mueller, 2004). Recent Slovene and international studies of dynamic enterprises examined the companies in light of their organization and further potential for rapid growth (Boccardelli and Magnusson, 2006; Macpherson and Holt, 2007; Nelson et al., 2007). Hölzl (2009), Haisu and Zhongxiu (2010), Mateev and Anastasov (2010) focused their attention on companies in several national economies (including China, Slovenia and other European countries) and analysed the reasons for their rapid growth and their influence on national economies. All came to the conclusion that the most successful companies are relatively young, small and niche-oriented.

**The Internationalisation Process**

Growth, development, and international business operations of companies play a vital role in successful economic development, creation of wealth and employment in every economy. In the literature, the process of business expansion outside local borders is known as
international business operations or business internationalisation. We use the expression internationalisation; the term is used by many other authors (Dunning and Lundan, 2008; Konečnik-Ruzzier, 2012; Konečnik-Ruzzier and Ruzzier, 2013). The internationalisation of Slovene dynamic companies is crucial to the growth of the Slovenian economy, especially because of the country’s small economic base; it is our contention that the ability of the economy to grow and to increase employment is directly related to the capability to create and support dynamic companies. As part of the European Union, Slovenia is part of a single market of almost 500 million consumers; if we consider only the Slovene market, the country seems small, but expanding to EU markets actually means that companies become international in the single European market (Bobek and Korez-Vide, 2005; Hauptman et al., 2011).

**The Legal Organisation of Dynamic Companies**

The most common legal organization of business entities is that of the limited liability company, followed by sole proprietorships and public limited companies, but there are also unlimited companies and limited partnerships. However, it must be emphasised that the names of the legal forms depend on the country in which company is registered. Companies can also be defined and classified according to a growth stages model. The stages include 1 – establishment (beginning of business operations); 2 – survival time (obtaining funds for growth); 3 – growth (supporting growth by takeovers and acquisitions) and 4 – decline (sale and harvest).

Companies often start as sole proprietorships or one-person limited liability companies. To start growing rapidly they need to obtain funds, frequently acquired in the form of a limited partnership. In general, sources of financing can be divided into debt and proprietary financing and in relation to content, into equity capital, venture capital, long-term and short-term loan capital, as well as state aid and resources (O’Regan et al., 2006). How a company obtains and uses its sources of finance depends on the legal form of the company. A sole proprietor who contracts loans from banks or from individuals as a natural person with full liability will for this reason probably not keep the same legal form during the entire lifetime of the company, especially if the company starts to grow with above average speed. For this reason, limited partnerships are a popular form of legal organisation for dynamic companies. In limited partnerships, the personal property of the entrepreneur is adequately protected and at the same time he or she still has freedom to do business in a way that enables successful and effective management of the company. According to the stages model, companies need to transform in the third or growth stage (if
arrangements for rapid growth have not been made beforehand) to fulfil financial as well as personnel, organisational, and legal requirements. In most cases they first transform into a multi-person limited liability company and later into a public limited company. This development route enables the company to mature and afterwards, before reaching the fourth or decline stage, achieve sales at the harvest stage (according to Foster et al., 2008).

In the first stages companies are usually financed by the entrepreneur, his or her family and friends, and also from retained profit. Therefore, in the initial stages, the company’s legal form is of less importance. However, if the company is to grow rapidly, additional external capital is required. From then on, the legal organisation of the company becomes important. To attract investors (in US American and European companies) additional equity financing is necessary in most cases. Companies can enter the financial markets with IPO (initial public offering) shares and, together with the entrepreneur, the investors who have invested in the company expect to earn a profit after five to seven years. In Slovenia, however, we are still mostly unaware of the concept of venture capitalists, or “business angels.” On the one hand there is a shortage of people with entrepreneurial experience and a willingness to invest in companies; on the other hand, successful companies neither need nor want equity capital. Venture capital funds in Slovenia are rare and too small to be able to substantially influence the financing of corporate growth. Few companies decide to sell their shares or participate in mergers, take-overs or shares in public offerings, which are the usual means of financing the growth of companies elsewhere. In Slovenia, only a few companies decide to become joint stock companies, and there are even fewer that make public offerings of shares or stocks (Hisrich and Antončič, 2004).

Methodology

Research direction

We surveyed Slovene companies which were placed on a national list of the 500 fastest growing companies in Slovenia for the period between 2007 and 2011 by the newspaper Dnevnik (Dnevnik, 2012) to find if there was a relationship between their legal form and the process of internationalisation. Companies were selected for Dnevnik’s list based on the index of sales income growth for the previous five years, added-value per employee, increase in the number of employees, and the DaBeg index (which makes it possible to compare growth in the number of employees between different companies). In order to be placed on the list the companies must also fulfil the following conditions:
1 – distributable profit in the previous financial year; 2 – at least EUR 220,500 sales revenues in the base year; 3 – the company had to operate in both index years during the entire 12 months and must have shown a profit in the previous year. We looked for a relationship between companies in the sample and their tendency to internationalise, and to find out if the form of legal organisation they chose had any effect on their success.

**Working Hypothesis**

Our hypothesis H1 is that legal form influences a company’s decision to start the internationalisation process. The hypothesis was formulated based on the findings of Pšeničnya et al. (2012) that most businesses operate as limited liability companies. It is in this form they most frequently begin their international operations. To verify this hypothesis, we performed a regression analysis between the dependent variable, the company's legal form, and several independent variables, including the amount of revenues in the preceding business year and business operations in selected foreign market.

**Data Gathering**

We used the online questionnaire survey method to gather data for our research. The questionnaire was created using software for developing online questionnaires. The questionnaire comprised 43 questions. The questions were divided into four content-related parts: part one – the company's basic data and ownership structure; part two – education and work experiences of the entrepreneur; part three – the company's business operations; part four – the company's business environment, part five – questions concerning the process and content of the company's internationalisation. Our hypothesis, described in section 3.2, mostly refers to questions from part five, which included 11 questions concerning the company’s internationalisation process.

First, a pilot or a test questionnaire was sent to randomly chosen companies from the sample to check whether the question sets were appropriate. The questionnaire was composed so that it did not take too much time to complete it. Email addresses of companies were collected in advance on the Internet and afterwards an introductory letter with a request to take part in the survey was sent to these companies. The email also contained a link to access the online questionnaire.

**Population and the Examination Sample**

Our research was conducted on a sample of 2500 Slovene companies which were ranked on the official annual list of “500 fastest growing
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companies in Slovenia” (Dnevnik, 2008–2012) during the period from 2007 to 2011. In the 2,500 companies a certain percentage of companies came up more than once (60% or 1,499 companies) as they made the list for several years in a row. The sample for further research and study was 1,499 companies. The expected response rate to the online questionnaire was between 2 and 3%. 78 companies answered the survey; hence, the sample of companies for further research was 78 companies.

**Statistical Data Analysis**

In the first stage, the empirical data acquired was processed in the EXCEL Programme (graphic display) and later on in the SPSS statistical programme to search for correlations and dependencies between individual variables. On the basis of the data processed, findings on the testing of the primarily set hypothesis relativity are given. Using regression analysis, we sought the relationship between the dependant variable (the company's legal form) and individual independent variables (the size of company’s revenues in the preceding business year and business operation in selected foreign market).

**Empirical Research**

**Characteristics of the Sample**

Based on our questionnaire survey in 2012 and further analysis of the answers gathered from the sample of 78 companies, we found that more than three quarters of companies which participated in the research had the legal form of a limited liability company. This form of organization has the most common legal form of companies in Slovenia for the past twenty years (Pšeničny et al., 2012). Most companies were initially financed by the savings of the company founder. In the Slovene domestic market, most companies did not convert their legal form from sole proprietorship to limited liability company, or did so in less than one tenth of cases. This is also true in foreign markets. On the domestic as well as on the foreign market, most companies are production and services (trade) oriented. For one-fifth of companies, an insufficient market, insufficient financing or inability to acquire resources, problems with the recovery of claims, and unfavourable government regulations were found to be the most important problems that hinder business operations in the domestic market. For dynamic companies, the Slovene domestic market was described as the most important market and, regarding the most important foreign markets, companies stressed markets in Slovenia’s neighbouring countries (Croatia, Italy, and Hungary), east and north European countries, and other countries of the
former Yugoslavia. End-consumers and wholesalers were the most important buyers in the domestic and foreign markets.

Most companies reported that they did not plan their internationalisation; it simply happened. The most widely used forms of internationalisation are direct export and contractual relationship with a foreign agent. In table 1 we present the key motives and reasons for internationalisation.

Table 1: Key motives and reasons for the internationalisation of dynamic companies

<table>
<thead>
<tr>
<th>Key proactive motives for internationalisation</th>
<th>higher profit and growth, wish to be the leading company in the field, competitive technological knowledge and capabilities, opportunities/information, economy of scale, tax relief.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Key reasons for internationalisation</td>
<td>seeking new markets (preserving/enlarging market share in foreign markets; the Slovene market is too small; lack of opportunities in the Slovene market; better response to the demands of local consumers), strategic reasons (company growth; preserving and/or strengthening competitiveness; risk, market and product diversification; expecting higher profit margins).</td>
</tr>
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The findings in table 1 were taken from data gathered on our questionnaire. The data and the findings are valid only for the sample of companies studied in this research.

**Influence of Legal Organisation on the Internationalisation Process**

We found that three-fifths of the companies surveyed are present in foreign markets with the export of services or products. Consequently, we concluded that they do not have their own branches in the foreign market and that they export directly to the foreign market. We also found that more than three-quarters of companies operating in the domestic and foreign markets operate with the status of a limited liability company, that they had already developed their business operations in the form of a limited liability company in the domestic market, and that they successfully used this mode of operation for their internationalisation. If we take into account the most frequent reason for internationalisation, which is entering new markets (Ruzzier et al., 2007), we can conclude
that companies must demonstrate fully functional business operations in the domestic market in the first place (Pšeničny et al., 2012).

To test our hypothesis further, we performed a regression analysis between the dependent variable, the company’s legal form (A19) at the time of establishment and the independent variables (A443 – presence in a foreign market in years). Table 2 shows the variables used for the regression analysis.

Table 2: Variables of the regression analysis

<table>
<thead>
<tr>
<th>Variables Entered/Removed</th>
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<tr>
<td>Model</td>
</tr>
<tr>
<td>1</td>
</tr>
<tr>
<td>a. Dependent Variable: A19</td>
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<tr>
<td>b. All requested variables entered.</td>
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</tbody>
</table>

Table 3 shows the results of our regression analysis. The first partial regression coefficient (between the company’s legal form and its presence on a foreign market expressed in years) amounts to -0.099 and is statistically insignificant (p = 0.184), which means that the presence in a foreign market expressed in years does not influence the company’s legal form.

Table 3: Results of the regression analysis – coefficients of individual variables (A19)

<table>
<thead>
<tr>
<th>Coefficients</th>
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<tr>
<td>Model</td>
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<tr>
<td>1</td>
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<tr>
<td></td>
</tr>
<tr>
<td>a. Dependent Variable: A19</td>
</tr>
</tbody>
</table>

On the basis of table 2 the following regression model equation was formulated:

\[ y_a = 1.563 + 0.567x_1 - 0.145x_2 - 0.133x_3 - 0.099x_4 \]

\( y_a \) – regression model equation
\( x_1 \ldots x_4 \) – partial regression coefficients
In the regression analysis, we were looking for relationships between the company's legal form at the time of its establishment (the dependent variable) and some independent variables which influence the decision regarding internationalisation and its process. We found that there are some statistically significant connections between the dependent and the independent variables; nevertheless, on the whole, individual decisions about the process of internationalisation do not influence the decision about the company's legal form. Based on the data and findings, the hypothesis was supported. On the basis of the data we conclude that most companies internationalise in the form of a limited liability company, or, more precisely, companies that engage in international activities already operated as limited liability companies on the domestic market. On the basis of our analysis, we can state that there is no statistically significant connection or dependence between the dependent and the independent variables, or, in other words, companies do not decide to incorporate as limited liability companies solely for the purpose of internationalisation.

Conclusion

Generally, companies that start operating during the same time period and which perform similar activities grow differently; this means that their success and existence are not predetermined. Companies which are led ambitiously by dynamic, business oriented entrepreneurs grow faster than those that just happen to be in the right place at the right time. Over the last twenty years, successful Slovenian companies have tended to be high-tech production and services oriented limited liability companies founded by an entrepreneur who is also the company owner. It is important to note that the small size of the Slovene market is an important factor that influences the fast growth of dynamic companies, as long-lasting fast growth is not possible without a strong export or international orientation.

Regarding the relationship between the legal organisation of a company and internationalisation, we argue that legal organisation does not influence the internationalisation process in and of itself, but nevertheless it has an indirect influence. In the last twenty years, most Slovene companies have operated as limited liability companies in the domestic market. We assume that they were engaged in the internationalisation process in this legal organisation as well or that they operated in this legal form in individual foreign markets (this is supported by export data over the last few years) and that for different reasons, such as legal liability of owners and shareholders and easier access to debt financing, this is the best legal form for the first steps toward internationalisation and for further business operations in foreign
markets. The legal form plays an important role in finding additional resources to finance growth. Financing and finding new investors is the easiest way to acquire financial resources. At the same time the legal form of the company also underlies most regulations in the case of joint stock companies, which is the most common form when it comes to medium sized and large dynamic companies. On this topic, the relationship between the form of the company and financing growth, more research should be carried out in future.

We conclude that internationalisation is of the utmost importance for the growth of companies in Slovenia and that internationalisation does not directly depend on the legal form of a company. However, it does depend on the ability of a company to provide suitable financial resources to stimulate rapid growth. The financial resources required for internationalisation and growth can be most easily acquired if a business operates in the form of a joint stock company. Therefore, internationalisation is the motor of growth and the legal form of a company does, in fact, affect it.
Resources


