THE INTERNATIONAL INVOLVEMENT OF FIRMS ON THE UNLISTED SECURITIES MARKET (USM).

ABSTRACT:

This paper focuses on the international involvement of companies on the Unlisted Securities Market. Background information is presented on the aims of the research study and the methodological approach adopted. The introduction proceeds with an outline of the major theories of internationalisation. The genesis and development of the Unlisted Securities Market is also summarised in the introductory text. The major focus of the paper is upon the characteristics of international companies on the USM. The findings are derived from an analysis of the Annual Reports of these companies.

AUTHORS:

Professor T. Cannon
Professor of Business and Management

Ms. J. McKay
Research Assistant
Scottish Enterprise Foundation

Dr. A. McAuley
Research Fellow
Scottish Enterprise Foundation

ADDRESS:

Department of Business and Management,
University of Stirling,
Stirling FK9 4LA
Scotland.
INTRODUCTION

The research upon which this paper is based forms part of a two-year project funded by the Economic and Social Research Council of Great Britain. Structurally, the paper will divide into four broad sections. The first section aims to place the research in perspective, outlining the objectives of the study and the research strategy to be adopted. The second section will provide a brief review of the major theories of internationalisation. In the third section the origins and workings of the Unlisted Securities Market (USM) will be outlined. This section will act as the bridge to the fourth section, the focal point of the paper, which reveals the characteristics of internationalised companies on the USM.

1. BACKGROUND TO THE STUDY

1.1 Research Objectives and Hypothesis

The purpose of the study is to examine the extent to which firms on the Unlisted Securities Market have adapted their domestic marketing techniques to the internationalisation of their business. The research proposes to examine the use of marketing research within the domestic market and its contribution to the internationalisation process; product, price and promotional policies at home and overseas; and finally, the role of intermediaries and support networks in international ventures. The basic hypothesis of the research is that firms which:

- are strongly market-orientated domestically,
- apply the same disciplines, skills and resources overseas,
- construct marketing strategies based on in-depth knowledge of the overseas market,
- base marketing decisions on local rather than domestic conditions, and
- integrate this process through comprehensive marketing plans,

will be more successful in the international arena than firms which fail to adopt this approach.
1.2 Research Strategy

Background research consisted of a review of literature on the Internationalisation of Firms and on the operation of the Unlisted Securities Market. USM companies were selected as the sampling population because these businesses, which are in the process of expanding, will adopt internationalisation as one possible strategy for growth. Annual Reports were obtained from companies on the USM, providing a useful bank of secondary information on these businesses. A statistical analysis of the data on the international UK companies was subsequently undertaken. Primary data will be collected at a later stage from in-depth personal interviews with a sample of international companies on the USM. It is intended that the sample will comprise 20 companies which are successful overseas and 10 companies which have failed in international ventures. Overseas turnover in excess of 50% of total turnover is taken as an indicator of successful overseas involvement and an orientation towards the international market-place. Conversely, unsuccessful involvement is signalled by withdrawal from export markets or by an overseas turnover figure remaining at less than 10% of total turnover in recent years. Interviews with the domestic and export marketing manager of these companies will yield valuable insights into the role of marketing at home and overseas. A comparative analysis of the marketing strategies of these thirty companies will be undertaken. This exercise will permit the development of case studies of best practices for the effective internationalisation of high-growth UK companies.

2. THEORIES OF INTERNATIONALISATION

The Behavioural theory focuses on the role of management in guiding a firm towards internationalisation. A positive correlation has been established between certain traits of management and involvement in international business activities. Simmonds and Smith found that an external stimulus was responsible for a firm's first export order. This however, was assisted by the
fact that top management adopted an aggressive and competitive stance, emphasised expansion and growth, and had a supra-national outlook. This finding is supported by the work of Langston and Teas\(^2\) who report that people with an interest in and experience of international affairs are more inclined to initiate exporting activity.

A spate of authors are proponents of a Stages approach to internationalisation (Bilkey\(^3\); Denis and Depelteau\(^4\); Cavusgil and Nevin\(^5\); Johanson and Wiedersheim-Paul\(^6\)). Their studies conclude that the internationalisation of a firm is a gradual process, taking place in incremental stages over a relatively long period of time.

Cavusgil\(^7\) points out that export marketing is usually considered to be a first step in the process of internationalisation. From their empirical work in Sweden, Johanson and Wiedersheim-Paul\(^6\) identified the stages of development as: no regular export activities; export via independent representatives; the organisation of sales subsidiaries; and ultimately, the establishment of a production unit.

Cavusgil\(^8\) attributes the sequential nature of this process to the increased risk and greater uncertainty which is associated with conducting international business. Hence, with experience, management may develop a more confident approach to international business based on a learning and feedback process, which is evident in the stages approach. Internationalisation is seen to begin in foreign markets which are most similar to those at home where the barriers to retrieval and interpretation of information are perceived to be less. However, evidence presented by Young\(^9\) indicates that the stages model is not applicable to every industry. A more revolutionary approach is taken by companies in the high-technology sector, which tend to engage in more rapid and distant international involvement.
3. **THE UNLISTED SECURITIES MARKET**

3.1 The Establishment of the USM

The Unlisted Securities Market was established in November 1980 in direct response to criticism of the Official Stock Exchange List. During the 1970's it was becoming increasingly difficult for the smaller company to join the Official List because of the cost of compliance with the conditions and rules of entry. The Wilson Committee Report\(^1\) concluded that the growth and expansion prospects of the small firm sector were inhibited by a lack of long term equity finance. The Stock Exchange envisaged that the establishment of the USM would make a vital contribution to the growth of smaller companies by providing them with capital to finance expansion and by enhancing their trading status and corporate image.

3.2 Requirements for Admission to the USM

The requirements for admission to the USM are, of necessity, less stringent than for a full listing on the Stock Exchange. A trading record of three years is required as opposed to five years for the Official List. In exceptional circumstances, however, companies with a shorter track record may be eligible for entry to the USM. These start-up ventures must provide evidence that funds are required to finance a product or project which is fully researched and costed. The Unlisted Securities Market has no minimum size of market capitalisation, whereas a minimum level of £700,000 is imposed for a company seeking admission to the senior market. USM companies must place at least 10% of their equity capital in public hands, which is substantially less than the 25% minimum requirement for the Official List. The costs of advertising are not prohibitive for newcomers to the USM. The regulation demands that details of sale be placed in one national newspaper. By contrast, companies seeking a listing on the senior market must publish their prospectus in full in two national newspapers.
3.3 Growth of the USM

For the smaller, expanding business, the USM, with its less stringent entry conditions, has proved a popular vehicle for quotation on the Stock Exchange. Since its inception in November 1980, the number of trading companies has continued to increase annually. Table 1 charts the development of this novel market from a membership roll of 23 trading companies in December 1980, to 86 after its first full year of operation, through to 370 at the close of 1987.

**TABLE 1: GROWTH OF THE USM**

<table>
<thead>
<tr>
<th>Year End</th>
<th>No of Trading Companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>23</td>
</tr>
<tr>
<td>1981</td>
<td>86</td>
</tr>
<tr>
<td>1982</td>
<td>141</td>
</tr>
<tr>
<td>1983</td>
<td>204</td>
</tr>
<tr>
<td>1984</td>
<td>270</td>
</tr>
<tr>
<td>1985</td>
<td>337</td>
</tr>
<tr>
<td>1986</td>
<td>368</td>
</tr>
<tr>
<td>1987</td>
<td>370</td>
</tr>
</tbody>
</table>

Source: Stock Exchange Fact Service

In total, during this seven year period of its existence, the USM attracted no fewer than 604 entrants. The pattern of exits from the USM serves as a useful measure of the progress of this market. The success of the USM is illustrated by the fact that 108 of the 234 departures represent transfers to the senior market. The USM is thus utilised by a number of high-growth companies as a springboard to officially listed status on the Stock Exchange. Acquisitions under offer account for 88 of the exits from the USM. Ten companies which have reorganised their structure have been re-admitted to the USM in their new form. The number of failures on the USM has been markedly small with the shares of 28 companies being the subject of a suspension or cancellation at the end of 1987. Table 2 provides a summary of these statistics.
TABLE 2: USM SUMMARY

<table>
<thead>
<tr>
<th>Description</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Admitted</td>
<td>604</td>
</tr>
<tr>
<td>Transferred to Listing</td>
<td>108</td>
</tr>
<tr>
<td>Acquired Under Offer</td>
<td>88</td>
</tr>
<tr>
<td>Cancelled</td>
<td>15</td>
</tr>
<tr>
<td>Suspended</td>
<td>13</td>
</tr>
<tr>
<td>Reorganised</td>
<td>10</td>
</tr>
<tr>
<td>Total Trading</td>
<td>370</td>
</tr>
</tbody>
</table>

Source: Stock Exchange Fact Service

4. **RESEARCH FINDINGS**

4.1 **Introduction to Findings**

Desk research identified a total of 363 companies trading on the USM at the end of October 1987. Annual reports were received from 340 of these companies, yielding an overall response rate of 94%. UK-based companies account for 318 of this total. 219 of the UK companies (69%) have some measure of involvement in international markets. However, data on overseas turnover was supplied by only 168 international companies, and it is on the characteristics of these companies that this review will focus.

4.2 **Location and Size of USM Companies**

The registered office address was taken as the base location of international USM companies. Although spread throughout the UK, two thirds are concentrated in a cluster in the South East of England.

Employment figures and volume of turnover were adopted as indicators of the size of USM companies. The average size of labour force is 251, a figure which places USM companies within the medium-size range. The average figure does however mask
enormous diversity in the size of USM companies—from a minimum of 3, the employee total rises to a maximum of 2,237. The smallest company, Cityvision, is engaged in film and video distribution, while the largest, Millward Brown, operates as a market research agency, recruiting on average 1,931 freelance interviewers for fieldwork. A mere 8% of international USM companies can boast a labour force in excess of 500.

The mean annual turnover for these internationalised businesses stood at £9.4m for the year 1984-85. For the year ended 1986, this figure had climbed to £10.5m, yielding an annual increase of 13%. A comparison with the 1987 figure shows growth in average turnover to a level of £12.8m, a substantial increase of 22% over the previous year. By volume of turnover, therefore, companies on the USM may be categorised as medium-sized concerns. The pronounced growth in average turnover is evidence that the USM is typically composed of vibrant and expanding businesses. At an individual level, for their last reporting year, 137 of the 168 companies (82%) experienced a growth in turnover which levelled out at an average increase of 43%. Ten international companies more than doubled their turnover in the last year for which data is available. The companies achieving phenomenal growth are concentrated predominantly in the electrical sector. Only a small proportion of companies, 18% in fact, reported a decline in turnover. From these findings it is apparent that high-growth is an identifying characteristic of international companies on the USM.

4.3 Organisational Complexity

USM members are typically an amalgam of a number of individual companies. The average USM firm holds ownership of six subsidiaries of trading, holding or dormant status. Not surprisingly, the majority of USM members exist purely as holding companies engaged in the provision of management and financial services to subsidiaries of the group. Only 30% of the internationalised companies have a trading status in their own right. USM companies in
ownership of a large number of subsidiaries display most complexity in their organisational structure. These companies are organised into a series of tiers, comprising the parent company, intermediate holding companies, direct subsidiaries and indirectly-held subsidiaries.

Figure 1 below illustrates the complex Group structure of American Business Systems:

**FIGURE 1: STRUCTURE OF AMERICAN BUSINESS SYSTEMS**

![Diagram of American Business Systems structure]

**CODE:**
1. Subsidiaries directly held by American Business Systems plc.
2. Subsidiaries held by Murray Oil & Gas Co.
3. Subsidiaries held by Danka Industries Inc.

Only 9 of the 168 companies studied are themselves subsidiaries of a larger organisation which has ultimate control over the group's destiny.
4.4 Acquisition of New Businesses

The acquisition of new businesses will undoubtedly contribute to the organisational complexity of USM members. The analysis shows that USM companies are on the acquisition trail, purchasing on average two companies per year. This figure includes direct and indirect acquisitions, and those businesses acquired through a subsidiary. It is apparent from this finding that USM members are pursuing acquisition as a route to growth and diversification. However, the search for acquisitions is by no means confined to the domestic market. In their last reporting year, ten companies cast their acquisition net into international waters, acquiring between them, directly or indirectly, a total of 25 foreign businesses.

4.5 International Involvement of USM Companies

The analysis revealed that over two-thirds (69%) of the UK companies quoted on the USM engage in international business activities. Although this proportion is extremely high, the extent of internationalisation of these companies is variable.

The overseas turnover of USM companies has increased from a mean figure of £1.8m for the year end 1985 to £2.7m in 1986 and to £3.5m in 1987. However, the virtual two-fold increase in overseas turnover during this period is notably from a low base.

The extent of internationalisation of USM companies is reflected in the percentage of annual turnover derived from markets overseas. For the period 1986-7 the average was 28%, a figure which has shown no change since 1985. Thus, although the volume of overseas turnover is rising, overall, for USM companies, export markets are not gaining in importance. The 28% mean for USM companies is marginally lower than the 30% quoted for an average international company. The USM export ratio is biased moreover by the existence of six companies, all but one engaged principally in the oil industry, which derive their total turnover from markets overseas. Omitting these companies from the sample,
overseas turnover would deflate to a level of 22% of total turnover. The implication is that USM companies, at the present time, are not internationalised to a high degree. Indeed, 35% of these companies have an overseas turnover measured at less than 10% of total turnover. While some of these companies may be classified as new exporters, it is probable that a large number in this category are uncommitted exporters, regarding exporting as a marginal activity, as a mechanism for absorbing excess production. A sizeable majority of internationalised businesses on the USM (62%) generate less than a quarter of their turnover in international markets. Export-orientated companies, defined as those deriving more than half of their turnover from overseas, account for only 21% of the total.

Table 3 indicates the extent of international involvement of USM companies.

**TABLE 3; OVERSEAS TURNOVER OF USM COMPANIES**

<table>
<thead>
<tr>
<th>% OF TURNOVER OVERSEAS</th>
<th>NO OF COMPANIES</th>
<th>% OF COMPANIES</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 - 9</td>
<td>58</td>
<td>35</td>
</tr>
<tr>
<td>10 - 24</td>
<td>45</td>
<td>27</td>
</tr>
<tr>
<td>25 - 49</td>
<td>29</td>
<td>17</td>
</tr>
<tr>
<td>50 - 74</td>
<td>21</td>
<td>12</td>
</tr>
<tr>
<td>75 - 100</td>
<td>15</td>
<td>9</td>
</tr>
</tbody>
</table>

4.6 International Markets

Table 4 indicates the international markets served by companies on the Unlisted Securities Market. The percentage of companies with known interests in these geographical markets is noted.
TABLE 4: INTERNATIONAL MARKETS OF USM COMPANIES

<table>
<thead>
<tr>
<th>MARKET</th>
<th>% OF COMPANIES IN MARKET</th>
</tr>
</thead>
<tbody>
<tr>
<td>EUROPE</td>
<td>67</td>
</tr>
<tr>
<td>N. AMERICA</td>
<td>56</td>
</tr>
<tr>
<td>MIDDLE EAST</td>
<td>11</td>
</tr>
<tr>
<td>AFRICA</td>
<td>11</td>
</tr>
<tr>
<td>AUSTRALASIA</td>
<td>11</td>
</tr>
<tr>
<td>S. AMERICA</td>
<td>8</td>
</tr>
<tr>
<td>FAR EAST</td>
<td>7</td>
</tr>
<tr>
<td>ASIA</td>
<td>7</td>
</tr>
<tr>
<td>UNDEFINED</td>
<td>65</td>
</tr>
</tbody>
</table>

These figures demonstrate that Europe is the most popular international destination for goods and services of USM companies. 67% of companies are active in the European market, while a slightly lower proportion (56%) derive turnover from North America. The reasons for this pattern are suggested by the concepts of geographic and psychic proximity. The closeness of Europe, however, is only a partial explanation for the high instance of involvement in this market. Membership of the EEC, providing access to wealthy, tariff-free zones, has played a major role in stimulating the development of exports to Europe. Significantly, markets which are more remote in terms of geographic or cultural distance are much less attractive to USM companies. Only 7% of companies have indicated involvement in Asia and the Far East, 8% in South America, and 11% in the Middle East, Africa and the distant continent of Australasia.

The most intensely developed markets are, not surprisingly, Europe and North America. For the 111 companies active in Europe, an average 55% of their overseas turnover emanates from this market. The comparative figure for companies in North America is slightly lower, averaging at 51% of overseas turnover.
Market Withdrawal

Six USM companies, currently active in the international arena, have withdrawn from the following export markets: - North America, Far East (2 companies), Africa, Asia and Other. It is noticeable that withdrawals are predominantly from markets which are geographically and culturally remote from the United Kingdom. Customers in these distant areas of the world may have needs and expectations which differ sharply from those held in the West. It is a reasonable assumption that a lack of cultural sensitivity on the part of these companies, a lack of product and marketing adaptation, contributed in many cases to failure in these markets.

4.7 Ownership of Subsidiaries Overseas

Half of the international companies under review own subsidiaries in export markets. However, at the level of the individual firm, the number of subsidiaries held is typically very low. 34 of these 84 companies are in control of only one subsidiary and 17 hold two subsidiaries. Thus, the majority (61%) hold ownership of only one or two subsidiaries in international markets.

In terms of location, 73% of companies with overseas subsidiaries have a base in North America, 48% have subsidiaries in Europe, and 18% in other markets. The combined percentage total exceeds 100 as an individual company may have subsidiaries in more than one overseas market. Thus, although Europe is the most important international market, here, reliance on intermediaries is predominant.

The concept of psychological proximity may be used as one explanation for the tendency to locate in North America. In this English-speaking market, the legal, financial and administrative problems surrounding subsidiary formation may appear to be less. Geographical distance is perhaps another factor favouring direct representation in this important market. It is difficult (though not impossible) for UK companies to maintain at such
distance personal contact with and control over intermediaries in North America.

The stages model would appear to hold some validity for companies on the USM. Less experienced or less committed companies, deriving under a tenth of their turnover from overseas, tend to focus on exporting directly or through independent intermediaries. Only 17% of companies in this category have a subsidiary organisation trading in overseas markets. By comparison, two-thirds of companies with overseas turnover between 50 and 75% have at least one subsidiary overseas. Service organisations, however, show a divergence from the sequential pattern of the stages model. The Pineapple Group, an operator of dance centres, established a subsidiary in New York to gain entry to the U.S. market. Similarly, for Moorgate, a marketing consultancy firm, the formation of a Spanish subsidiary was the direct route to business development in Spain and Portugal. The Stages Model is thus limited in its ability to explain the internationalisation of service industries which tend to by-pass the exporting phase. It is generally not feasible for such firms to attract a volume of international business or serve world markets from the domestic base. For these businesses, the organisation of subsidiaries overseas often constitutes the first and final stage of involvement in international markets.

4.8 Business Activities

International Companies on the USM were categorised by their principal class of activity. The primary sector accounts for 5% of international USM companies, the secondary sector for 56%, Intermediate Construction for 1%, Intermediate Communication for 2% and the Tertiary Sector for 36%. 37 companies (22%) span two of these classifications, a finding which illustrates the diverse nature of international companies on the USM. The predominance of the manufacturing industry is not a striking finding. Service and construction industries, it must be realised, have less potential to internationalise.
International companies were further categorised by their field of business. Focusing on the principal activity of these companies, the electrical sector is the most important, accounting for 31% of international companies. The Industrials Miscellaneous category is also well represented on this basis, with 20% of international USM companies active in this sector. The diverse interests of USM companies are marked by the involvement of 39 companies in two industrial sectors, four companies in three sectors, and by the participation of one company in four sectors of business. This company, Hughes Food Group, has interests spanning the Food and Grocery sector, Industrials Miscellaneous, Property and the Hire Purchase and Leasing sector. Diversification of business interests is further exemplified by Rockwood Holdings. Originally with activities in electronic component distribution and security consultancy, the Group is now, following acquisitions, also engaged in tobacco and food distribution.

The Unlisted Securities Market provides examples of companies which have totally altered the major focus of their business. One such company, Hobson, was to the end of 1986 engaged principally in the development of the Hobson Process for the manufacture of extrusion dyes. Following acquisitions in 1986 and 1987, and the sale of this business, the Group now operates as exporters and commodity traders. To 1986 the sole activity of New Court Natural Resources was oil and gas exploration and production. The acquisition of Danka Industries in December 1986 directed the Group into its new, principal area of business - the supply and servicing of business equipment. The company name was changed to American Business Systems to reflect the new activity and the majority of its oil and gas interests have now been sold. The examples cited above serve to indicate the opportunistic approach to business adopted by USM companies, which tend to move into new and uncomplimentary areas of business as openings appear.
SUMMARY OF FINDINGS

The findings show that USM companies are adopting internationalisation as one strategy for growth. The majority of these medium-sized companies are not however internationalised to a significant extent, deriving less than a quarter of their turnover from overseas. The favoured markets are North America and Europe, a choice which can be justified by their psychological or geographical proximity to the UK market. Subsidiary ownership is common in the North American market, whereas Europe, on the other hand, tends to be served by independent intermediaries. Acquisition is typically adopted by USM companies as a route to growth, but for a small number, acquiring overseas, it forms part of their strategy for overseas expansion. Diversification through acquisition is common among USM companies, many of whom operate in more than one field of business.
REFERENCES

1. Simmonds K. and Smith H.  

2. Langston C.M. and Teas R.K.  
   Export commitment and characteristics of management, paper presented at the Annual Meeting of the Midwest Business Association, St. Louis, Missouri, 1976.

3. Bilkey W.J.  

4. Denis J.E. and Depelteau D.  

5. Cavusgil S.T. and Nevin J.R.  


