

STRATEGIC DUE DILIGENCE AS A TOOL FOR ASSESSING SME INTERNATIONAL MARKET ENTRY PROFITABILITY

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Abstract. *International expansion is an important growth path for small and medium-sized enterprises (SMEs), but it is exposed to uncertainty, incomplete information and the risk of overestimating viability. This paper proposes Strategic Due Diligence (SDD) as a conceptual decision-support tool for assessing SME foreign-market entry before resources are committed. The study is based on a structured review of articles and institutional reports from 2010-2026, complemented by expert reflection from due diligence, valuation and strategic advisory practice. The paper develops the SDD-5M model, covering five dimensions: market, competitive, regulatory-legal, financial-operational and cultural-institutional. The model explains how information asymmetry and optimism bias may distort revenue forecasts, margin assumptions, costs, compliance burdens, working-capital needs and the discount rate used in appraisal. Its theoretical contribution links SME internationalisation theory, information economics, prospect theory, transaction-cost reasoning and value-based management. Its practical contribution shows how strategic findings can inform DCF parameters, including sales volumes, EBITDA margins, CAPEX/OPEX and risk premia. SDD-5M is not an automatic valuation algorithm, but a heuristic framework supporting evidence-based entry decisions. The article defines its boundary conditions: it is most useful for SMEs entering their first*

or second foreign market through export, distribution, branch or joint venture. Applicability is more limited in microfirms, born-global firms and highly regulated sectors. The study concludes that SDD may reduce overestimation of market attractiveness and underestimation of adaptation costs, improving strategic and financial decisions in SME internationalisation. It also highlights the need to combine secondary-data analysis, selective interviews, legal verification and scenario testing so that managers can compare entry modes, adjust expansion scale and partner choice before scarce resources are committed.

Keywords: *strategic due diligence; SME internationalisation; information asymmetry; optimism bias; enterprise valuation; value-based management.*

Introduction. The international expansion of small and medium-sized enterprises is among the most demanding strategic decisions made under conditions of limited resources, high uncertainty and incomplete information. The European Commission defines SMEs as enterprises with fewer than 250 employees and turnover not exceeding EUR 50 million [7]. Although this sector generates more than half of European value added, only around one quarter of European SMEs engage in export activity [8], and some firms withdraw from foreign markets shortly after entry [23].

This study argues that one important reason for the limited sustainability of SME international expansion is a distorted assessment of economic viability. Information asymmetry and optimism bias may cause market, competitive, regulatory and operational risks to be insufficiently reflected in cash-flow projections or in the discount rate. Although strategic due diligence (SDD) is well established in mergers and acquisitions practice [9], its use as an autonomous tool for assessing SME foreign-market entry remains underdeveloped in management research [4].

The aim of the study is to explain how information asymmetry and optimism bias distort the assessment of SME expansion viability, to propose the conceptual SDD-5M model, to define its conditions of applicability and to show how its findings may inform selected parameters of financial appraisal. Four research questions are

addressed: what dimensions should an SME-oriented SDD model include; how do information asymmetry and optimism bias lead to valuation errors; under what boundary conditions is SDD-5M justified; and how can its findings be translated into valuation parameters?

The contribution of the study is theoretical and conceptual. It integrates information asymmetry and optimism bias into one explanatory framework for SME expansion-valuation errors, proposes the SDD-5M model as a five-dimensional decision-support framework, links SDD findings with financial appraisal and specifies the model's boundary conditions.

1. Methodology and epistemological status

This study is theoretical and conceptual. It is based on a structured, problem-oriented literature review, complemented by expert reflection derived from practical experience in due diligence, business valuation and strategic advisory work for SMEs. Its purpose is not to test statistical relationships, but to structure the mechanisms that may lead to erroneous assessments of international expansion profitability and to propose an analytical framework for interpreting them.

The review was conducted in Scopus, Web of Science and Google Scholar for publications from 2010 to 2026. Classic works relevant to information asymmetry, prospect theory, internationalisation and transaction costs were also included. Sources were selected according to their relevance for explaining erroneous profitability assessments in SME international expansion and for constructing the SDD-5M model.

The analysis covered publications concerning at least one of three areas: SME internationalisation and entry barriers; strategic due diligence and risk analysis; and financial appraisal of expansion projects and value-based management. After duplicate removal and assessment of titles, abstracts and full texts, 57 peer-reviewed articles and 14 institutional reports were included, supplemented by 9 seminal works identified through citation tracking. In total, 80 items were analysed.

The construction of the SDD-5M model was sequential. First, the SME internationalisation literature was used to identify uncertainty areas accompanying

foreign-market entry. Second, due diligence literature supplied the diagnostic logic of ex ante risk identification. Third, value-based management and financial appraisal were incorporated to show how information asymmetry affects cash-flow projections, cost structures and discount rates [35]. The proposed model is therefore a conceptual and heuristic tool rather than an empirically validated measurement instrument.

2. Information asymmetry, optimism bias and SDD in internationalisation theory

Information asymmetry between an SME and the target market, well described in information economics [1; 30], and optimism bias, as conceptualised within prospect theory [16], constitute two coexisting sources of erroneous assessment of international expansion. Acting jointly, they may lead to systematic overstatement of the NPV of expansion projects: underestimated risks are inadequately reflected either in revenue projections or in the discount rate.

The distortion operates across the five dimensions of SDD-5M. At the market level, an incorrect assessment of TAM/SAM and distribution channels inflates revenue projections. At the competitive level, underestimating competitor reactions inflates margins. At the regulatory-legal level, omitted compliance costs understate entry costs. At the financial-operational level, incorrect cost structures and cash-flow assumptions distort the DCF model. At the cultural-institutional level, underestimated cultural distance lowers the risk premium in the discount rate.

This mechanism is consistent with major theories of internationalisation. The Uppsala model describes internationalisation as a sequential knowledge-development process in which uncertainty declines with experience [13; 14]. Its later version stresses liability of outsidership, understood as the constraint arising from weak embeddedness in local business and institutional networks [14]. Transaction Cost Theory justifies SDD as an investment in reducing ex ante transaction costs [3; 36]. Dunning's OLI paradigm is reflected in the model structure: market and competitive dimensions address location advantages, financial-operational and regulatory-legal dimensions address ownership advantages, and the cultural-institutional dimension addresses internalisation conditions [6].

Compared with corporate due diligence, SDD for SMEs differs in scope, data access and decision logic. Corporate due diligence relies on extensive documentation and specialised expert teams, whereas SME-oriented SDD must operate with limited resources, public data, selective interviews and a gradual entry logic. Its key distinction is project-level assessment under SME resource constraints [9; 10; 38].

3. Barriers to SME internationalisation as sources of information asymmetry

Research on export barriers confirms that SME internationalisation is constrained by a broad set of internal and external obstacles. Kahiya identifies 50 types of export barriers in five decades of research [15], while Leonidou distinguishes internal and external barriers hindering small-business export development [20]. Child, Karmowska and Shenkar emphasise that institutional and cultural context remains insufficiently integrated into explanations of SME internationalisation [4].

From the perspective of expansion valuation, three categories of barriers are particularly important. Information-asymmetry barriers generate errors at the market and competitive levels. Regulatory-legal barriers lead to understatement of entry and compliance costs. Cultural-institutional barriers may understate the risk premium in the discount rate; empirical work shows that cultural distance increases the risk of market exit [2]. When these barriers interact with optimism bias, firms may systematically overestimate market attractiveness and underestimate adaptation costs.

4. The SDD-5M model: dimensions, indicators and decision implications

The SDD-5M model operationalises the mechanism through which information asymmetry and optimism bias distort the assessment of international expansion profitability. Its purpose is not merely to list risk factors, but to structure their analysis so that the results can be used in the economic appraisal of an expansion project.

The model identifies five areas corresponding to distinct levels of information asymmetry: market, competitive, regulatory-legal, financial-operational and cultural-institutional. Each dimension is linked to theoretical traditions and to a specific source of valuation distortion. Table 1 summarises the literature-model synthesis.

Table 1. Literature-model synthesis map for SDD-5M

Dimension	Key sources	Source of valuation distortion	Theoretical tradition
Market	Johanson/Vahlne; Kahiya; Leonidou	Overstated revenue projection	Uppsala model; industrial organisation
Competitive	Porter; Teece et al.	Overstated margins and underestimated reactions	Five forces; dynamic capabilities
Regulatory-legal	Barkema et al.; Kostova	Understated entry and compliance costs	Institutional theory
Financial-operational	Copeland et al.; Rappaport; Węgrzyn	Incorrect discount rate and cash-flow assumptions	VBM; transaction-cost economics
Cultural-institutional	Hofstede; GLOBE; Shenkar	Understated cultural-risk premium	Cultural distance; institutional theory

Source: Authors' own elaboration based on a structured literature review and synthesis of internationalisation theory, due diligence, value-based management and institutional-cultural determinants.

The market dimension concerns the scale and accessibility of demand in the target market. Key indicators include TAM/SAM, market growth, saturation, distribution-channel structure, distributor margins and access barriers. Low market accessibility or entry barriers exceeding the SME's resources may justify discontinuing further analysis or changing the entry mode.

The competitive dimension addresses the actual intensity of competitive pressure and its impact on achievable margins. It moves beyond static sector analysis towards dynamic competitive intelligence. Indicators include market shares of leading competitors, cost position, historical reactions to new entrants and price comparison at full entry cost [25; 31]. If a sustainable price-, quality- or relationship-based advantage cannot be built, sales and margin assumptions should be revised.

The regulatory-legal dimension identifies risks that may prevent or significantly delay implementation regardless of market attractiveness. Indicators include compliance costs, certification time, tax and contractual risks, and indicators

of institutional quality such as the World Bank's Worldwide Governance Indicators and Transparency International's Corruption Perceptions Index [32; 37].

The financial-operational dimension is the integration point of the model because it translates identified risks into appraisal parameters. It covers break-even analysis, liquidity capacity, scenario analysis, cash-flow sensitivity, working-capital requirements and, where debt financing is used, debt-service capacity [35].

The cultural-institutional dimension captures risks arising from cultural differences, institutional quality and business-environment predictability. It incorporates Hofstede's cultural dimensions, the GLOBE study, Shenkar's concept of psychic distance and Kostova's institutional perspective [11; 12; 18; 28]. These factors may affect adaptation costs, contract enforcement and the risk premium used in valuation. Table 2 presents the model's core indicators and decision implications.

Table 2. SDD-5M model - indicators and indicative decision-making implications

Dimension	Key indicators	Decision-making implication	RQ
Market	TAM/SAM; market growth; channel access; distribution structure	Low accessibility or weak demand may justify abandoning the market or changing the entry mode	RQ1, RQ2
Competitive	Leader shares; margins; competitor reactions; price and quality comparison	Weak competitive advantage may require revision of sales and margin assumptions	RQ1, RQ2
Regulatory-legal	Compliance requirements; adjustment time and cost; regulatory and tax risk	High burdens may justify postponement, a different partner or another form of presence	RQ1, RQ3
Financial-operational	Cash flows; working capital; liquidity capacity; scenarios	Low resilience may indicate the need to reduce scale or abandon the project	RQ1, RQ4
Cultural-institutional	Cultural distance; institutional quality; contract enforcement	High distance may support indirect entry, local partnership or additional safeguards	RQ1, RQ3

Source: Authors' own elaboration based on the structured literature review and the sequential logic of constructing the SDD-5M model.

5. Operationalisation, valuation integration and scope of applicability

The practical value of SDD-5M lies in translating strategic findings into financial-appraisal assumptions. The model does not replace DCF analysis, but provides structured evidence for verifying revenue, margin, entry-cost, working-capital and risk-premium assumptions. Table 3 presents an indicative translation scheme.

Table 3. Directions for translating SDD-5M results into valuation parameters

Dimension	Valuation distortion	Valuation parameter	Direction of correction
Market	Overstated revenues	Sales volume in the base DCF scenario	Downward correction when channel barriers or low TAM are identified
Competitive	Overstated margins	EBITDA margin and prices	Downward correction under strong competition
Regulatory-legal	Understated entry costs	CAPEX/OPEX; compliance costs	Upward cost correction and lower NPV
Financial-operational	Incorrect cash flows and discount rate	WACC; working capital; liquidity risk	Expert verification of assumptions
Cultural-institutional	Understated risk premium	Market-risk premium	Possible expert adjustment of the discount rate

Source: Authors' own elaboration based on the conceptual logic of translating SDD-5M findings into valuation parameters.

The discount rate used in the DCF model includes the base cost of equity estimated through the build-up approach, which adds the risk-free rate and risk premiums: market, size, industry and project-specific premiums. In non-listed SMEs, additional adjustments may be needed for limited liquidity, low diversification and greater operational sensitivity [35]. SDD-5M should therefore be treated as a structured basis for expert calibration rather than an automatic algorithm for determining the discount rate.

The model's effect may be illustrated by a hypothetical manufacturing SME planning market entry through a local distributor. Before SDD-5M, the firm assumes annual revenues from year 2 of PLN 8 million, an EBITDA margin of 14%, entry expenditure of PLN 2.5 million, a five-year horizon and a discount rate of 9%, giving

an NPV of approximately PLN 1.2 million. After applying SDD-5M, projected revenues are reduced by 15%, the EBITDA margin falls to 10%, compliance and documentation costs increase entry expenditure by PLN 0.6 million, and the discount rate is adjusted to 11%. The project becomes only marginally profitable.

Table 4. Illustrative impact of applying SDD-5M on international expansion appraisal

Parameter	Initial assessment	Assessment after SDD-5M
Annual revenue from year 2	PLN 8.0 million	PLN 6.8 million
EBITDA margin	14%	10%
Entry expenditure	PLN 2.5 million	PLN 3.1 million
Discount rate	9%	11%
Project NPV	approx. PLN 1.2 million	approx. 0 / slightly negative

Source: Authors' own elaboration. Hypothetical data, for illustrative purposes only.

The implementation of SDD-5M may follow a three-phase funnel: secondary-data analysis, primary verification through interviews and legal analysis, and final synthesis leading to an SDD report containing a map of information-asymmetry risks and a business rationale for the DCF model [5; 27; 29]. Entry-mode recommendations follow from the synthetic assessment of model results: high attractiveness and low regulatory distance may support direct entry; moderate attractiveness with regulatory risk may support joint venture or licensing; weak certainty or high distance may support test export through a distributor [6; 14; 38].

The model is not universal. It is best suited to SMEs entering their first or second foreign market through export, distribution, a branch or joint venture. Its application is more limited in microfirms, born-global firms with developed networks and sectors subject to mandatory government concessions. Table 5 specifies the main boundary conditions.

Table 5. Scope of applicability of the SDD-5M model

Boundary dimension	Optimal application	Limited applicability	Outside the scope
Firm size	SMEs: 10-249 employees, turnover EUR 2-50 million	Microfirms - simplified version	Multinational corporations
Stage of internationalisation	First or second foreign market; test export or branch	Firms in more than five markets - rapid screening	Born-global firms with developed networks
Industry	Manufacturing, professional services and technologies	E-commerce - simplified regulatory dimension	Industries requiring mandatory government concessions
Geographical direction	EU, Central and Eastern Europe, DACH, United Kingdom	Emerging markets - deeper Phase II required	Markets without reliable data or legal support
Entry mode	Export, distribution, branch, joint venture	Greenfield FDI - requires technical due diligence	Acquisitions - require full corporate M&A due diligence

Source: Authors' own elaboration based on the structured literature review and the sequential logic of constructing the SDD-5M model.

6. Conclusions, implications and research perspectives

The answers to the research questions can be summarised as follows. First, an SME-oriented SDD model should include five dimensions: market, competitive, regulatory-legal, financial-operational and cultural-institutional. Each dimension refers to a separate level of information asymmetry and has specific decision implications. Second, information asymmetry and optimism bias may jointly lead to the systematic overstatement of the NPV of international expansion projects because market risks are not sufficiently reflected in revenues or discount rates.

Third, the model is applicable primarily to SMEs with limited but real analytical capacity, especially those entering their first or second foreign market. Fourth, SDD-5M findings may be translated into valuation parameters by correcting

sales volumes, margins, entry costs, working-capital assumptions and the risk premium. These corrections remain expert-based and require project-specific judgement.

The study contributes to the literature in three ways. It connects information asymmetry theory and prospect theory with SME internationalisation decisions in a framework explaining expansion-valuation errors. It proposes the SDD-5M model as a conceptual decision-support framework. It also links due diligence findings with value-based management and financial appraisal, particularly DCF assumptions.

The model has limitations. It has not yet been empirically validated; it assumes access to secondary data and basic market analysis; it may require adaptation in highly regulated industries and politically risky markets; and its criteria are indicative rather than universal thresholds. SDD-5M does not eliminate uncertainty, but it may reduce the risk of misjudging it.

The practical implication is that SMEs should not enter foreign markets solely on the basis of expected sales potential. They should first examine market accessibility, competitive pressure, regulatory burdens, financial resilience and cultural-institutional risk. Further research should empirically test the model across industries, geographic directions and entry modes, and examine whether it improves the accuracy of financial assumptions and reduces suboptimal expansion decisions.

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