



# 2003 Observatory of European SMEs

**2003/4** Internationalisation of SMEs



European  
Commission

# Observatory of European SMEs

## 2003, No. 4

# Internationalisation of SMEs

This report has been prepared from information provided by all partners of the European Network for SME Research ENSR (see Annex III) and was coordinated by Mr. Leif Jakobsen and Ms. Veronica de Voss from Oxford Research, the Danish ENSR partner.

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## OBSERVATORY OF EUROPEAN SMEs

A series of reports submitted to the Enterprise Directorate-General of the European Commission (see also Annex III to this report) by:

### KPMG Special Services and EIM Business & Policy Research in the Netherlands

in co-operation with:

### European Network for SME Research (ENSR), and Intomart

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AT	Austria	NL	Netherlands
BE	Belgium	PT	Portugal
DK	Denmark	SE	Sweden
DE	Germany	UK	United Kingdom
EL	Greece	EU	European Union
ES	Spain	IS	Iceland
FR	France	LI	Liechtenstein
FI	Finland	NO	Norway
IE	Ireland	EEA	European Economic Area
IT	Italy	CH	Switzerland
LU	Luxembourg	Europe-19	EEA plus Switzerland

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# Preface

Enterprises are at the heart of the strategy launched by the European Council in Lisbon in March 2000. Reaching the objective of becoming the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth, creating more and better jobs, and developing greater social cohesion will ultimately depend on the success of enterprises, especially small- and medium-sized ones.

The *Observatory of European SMEs* was established by the Commission in December 1992 in order to improve monitoring of the economic performance of SMEs in Europe. Its task is to provide information on SMEs at the national and European level.

The reports of the *Observatory* provide an overview of the current situation in the SME sector in Europe through statistics on the number of enterprises, on total employment, and on production by size of enterprise. In addition, the *Observatory* reports cover a range of thematic issues.

The *Observatory of European SMEs* covers 19 countries: the 15 countries of the EU, plus Iceland, Liechtenstein, Norway, and Switzerland.

In 2003 and 2004, the following reports are planned:

- Competence Development in SMEs
- SMEs and Access to Finance
- SMEs in Europe 2003
- Highlights from the 2003 Survey
- Internationalisation of SMEs
- SMEs and Co-operation
- The Impact of EU Enlargement on European SMEs
- SMEs and the Liberalisation of Network Industries

The research for the *Observatory* reports is carried out on behalf of the Enterprise Directorate-General of the European Commission by ENSR, the European Network for SME Research, co-ordinated by EIM Business & Policy Research from the Netherlands in a consortium led by KPMG Special Services from the Netherlands.

The *Observatory of European SMEs* is managed in the Enterprise Directorate-General by Unit A-5, 'Competitiveness Analysis and Benchmarking'.

*For a description of the activities of the Enterprise DG, see the website of the European Commission:*  
*<http://europa.eu.int/comm/dgs/enterprise> For more information on the Observatory of European SMEs, including how to access or order the reports, see:*  
*[http://europa.eu.int/comm/enterprise/enterprise\\_policy/analysis/observatory.htm](http://europa.eu.int/comm/enterprise/enterprise_policy/analysis/observatory.htm)*  
*Information on previous reports of the Observatory may be found there as well.*



# Summary

## Internationalisation of SMEs

Traditionally, internationalisation e.g. exporting has been seen as a way to increase turnover of individual enterprises. Exporting, as the traditional way to internationalise, is still very important, but during the last decade, internationalisation has become a much more differentiated business activity of crucial importance for achieving competitiveness.

Foreign partnerships, foreign investments and cross border clustering represent viable ways to facilitate exchanges of knowledge and technology and to strengthen international business strategies of SMEs. Such international activities cover both outward (e.g. sales/export) and inward (e.g. import or access to knowledge) activities along the value chain. Exporting firms are also often involved in a range of inward and related activities that interact with each other.

This report underlines that internationalisation consists of a broad range of activities that contribute to the development of enterprises' competitiveness. However, this holistic approach has not been adopted sufficiently by policy measures aiming to encourage internationalisation and at increasing firms' competitiveness.

Below, the main findings of the report are summarised:

- The ENSR Survey shows that foreign supply relationships are the most common form of internationalisation, being the case for 30 per cent of all SMEs. The second most prevailing form of internationalisation is exporting, undertaken by 18 per cent of SMEs. Three per cent of the surveyed SMEs have collaborative relationships primarily with foreign SMEs. Another three per cent have established foreign subsidiaries or branches.
- Exports are more frequent in combination with a foreign supplier. More than 10 per cent of the SMEs have exports and a foreign supplier, whereas only 6 per cent just export. National studies also find that importing often triggers exporting in SMEs. This indicates a synergy effect in combination of several international activities.
- Although the results from the ENSR Enterprise Survey 2003 indicate that importing and exporting are the most common forms of internationalisation, other studies indicate that co-operative approaches, alliances and networks involving SMEs will intensify in the future. Internationalised SMEs also engage in co-operation more frequently than SMEs in general. This is true both for formal co-operation (42 % of the SMEs with subsidiaries compared to only 24 % for the non-internationalised), but even more so for non-formal co-operation, which is undertaken by 50 per cent of the exporting SMEs and 53 per cent of the SMEs with foreign subsidiaries.
- Access to know-how and technology is a frequent motive for going abroad. As many as 38 percent of the SMEs with subsidiaries abroad do not have any exports. The creation of subsidiaries abroad is thus not merely a question of getting a sales platform. Moreover, 48 percent of exporting SMEs export, at least partly, in order to acquire knowledge. Export activities may thus imply co-operation with buyers on product development or technologies. The decision to go international is therefore an important means of gaining know-how and insight into useful technologies.
- Smaller countries, with small domestic markets, are more internationalised. The size of the domestic market is a very decisive factor for internationalisation. Hence, SMEs with a specialised production or some large production in a small country will very soon find that the demand on the domestic market is insufficient for sound business. Tendencies for increasing specialisation globally are likely to push an more SMEs into international business.



- Medium-sized enterprises are more involved in international activities than small and micro enterprises. Only 17 per cent of micro enterprises export, whereas 51 per cent of medium enterprises are exporters. However, while the likeliness to find an exporting SME increases with the company's size, the export share of the turnover does not correlate with size.
- Internationalisation, and especially co-operation, increases competitiveness. The ENSR survey along with national studies support the theory that internationalisation has a positive impact on competitiveness. However, co-operation as an activity is perceived by the SMEs to have an even greater positive effect on competitiveness than internationalisation. This finding strongly underlines the fact that internationalisation has to be viewed in a very broad perspective including not only trading but also international collaborative activities.
- The Internet is an important tool for internationalisation. Web-based sales, Internet marketing, and communications networks can be important factors to help SMEs internationalise, and data from the Observatory of European SMEs (1999-2002) show significant progress in SMEs' access to the Internet. In 2002, it was estimated that 70-75 percent of European micro enterprises had access to the Internet, and this was true for more than 85 per cent of small and medium-sized enterprises.
- Few SMEs perceive internal or external barriers. The most frequently cited internal barrier is the 'high costs of internationalisation'. This is mostly felt by SMEs with more complex international activities such as establishments abroad (24 %). Nevertheless, more than one third mentioned no internal barriers. Other studies indicate a considerable lack of internal managerial planning activities in relation to the internationalisation process. External barriers also seemed relatively infrequent. The most cited external barrier to internationalisation is 'existing laws and regulations', cited by 29 percent of SMEs with foreign subsidiaries.
- There seems to be a need for policy measures with a holistic approach to internationalisation targeting the individual SME. The European countries in general have a wide spectrum of basic policy measures available to SMEs to promote internationalisation, mainly exporting and FDI. These range from basic information services to more company-specific measures such as individual counselling and competence development, however primarily directed towards export promotion.

The findings in this report point to three elements as crucial for developing holistic policy measures with regard to internationalisation:

- Firstly, SMEs' managers often have limited time and management skills. A policy measure should consider providing some practical tasks to support the manager, especially in the case of SMEs with low international experience.
- Secondly, studies indicate that SMEs often need specific, targeted support. Such 'customised' support comprises, for instance, assistance in identifying an appropriate foreign business partner for a joint venture or collaboration. Moreover, recent studies indicate that SMEs' awareness of support measures is low due to the measures' traditional focus on export activities. The studies suggest that policy measures, in order to be effective, need to focus on the experience of the entrepreneur and on developing his/her qualifications in a broad sense.
- Finally, this report maintains that internationalisation is more than just exporting. Policy measures, whether general or company-specific, need to encompass all the different approaches to internationalisation and the support to include a wide range of international activities.

# Chapter 1

## Introduction

### 1.1. Internationalisation in a globalised economy

During the last decades, the global business scene and the European one in particular have enhanced international competition affecting both enterprises with an export profile and enterprises focusing on the domestic market. Some of the main drivers for the increasing internationalisation of SMEs are rooted in political, technological and economic changes.

Generally, WTO is dedicated to liberalising international trade conditions. In Europe there has been tighter integration and an ongoing enlargement of the European market as well as general trends of market liberalisation and deregulation resulting in the creation of a single European market. Former trade barriers have been, or are expected to be, eliminated, and a more efficient market should emerge to the benefit of the consumers.

Technology has dramatically improved the access to information and communication as well as the possibilities of managing a geographically scattered production. One should also add that more efficient and low-priced types of transportation for both goods and personnel have emerged.

The political changes and the declining costs of transportation have led to a more internationalised production structure and a new situation with global competition has emerged<sup>1</sup>.

Exporting, as the traditional way to internationalise, is still important, but during the last decade, internationalisation has become a much more differentiated business activity. Recent research<sup>2</sup> into internationalisation has found that a majority of firms engage in both outward (e.g. sales/export) and inward (e.g. import or access to knowledge) activities in the international arena. It has been found that of the firms engaged in export business, a majority was not confined to exporting alone but also involved in a range of inward and linked forms of international behaviour that interacted.

In other words, foreign partnerships, foreign investments and cross border clustering represent new viable ways to strengthen the international business strategies of SMEs. Such diverse international activities may integrate different business functions (i.e. R&D, marketing, production) and thus involve elements across the entire value chain<sup>3</sup>.

Furthermore, there is evidence that the presence in the foreign outlet markets and the possibility to de-localise part of the value chain allow SMEs to achieve more solidity and durability in production and, in general, in all their economic activities compared with other SMEs that develop a strategy which is purely based on exporting.<sup>4</sup>

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1 Porter, M. E., *The competitive advantage of nations*, London, 1990.

2 Fletcher, R., *A holistic approach to internationalisation*, *International Business Review* 10, 25-49, Pergamon, 2001.

3 A firm's value chain is an interdependent system or network of activities, connected by linkages. The primary activities of the value chain may be summarised in five categories: inbound logistics, operations (or manufacturing), outbound logistics, marketing & sales and after-sale service. Then there are the support activities of the value chain: firm infrastructure, human resource management, technology development and procurement. Gaining competitive advantage requires that a firm's value chain is managed like a system rather than a collection of separate parts. (Porter, M. E.: *The competitive advantage of nations*, London, 1990).

4 Spigarelli, F., *Processi di internazionalizzazione delle PMI. Un'analisi empirica sul contesto produttivo marchigiano* (Internationalisation processes of SMEs. An empirical analysis of the productive context of the Marche region), *Economia & Management* No. 3/2003, SDA Bocconi, Milan, 2003.

Traditionally, exporting has been considered the main approach to becoming an internationalised enterprise. The introduction of the value chain perspective into the discussion of internationalisation is broadening the perspective considerably, where internationalisation consist of a palette of activities of considerable importance not only for international trade, but also for the ability of being competitive in an international business environment.

The development within the Danish textile industry<sup>5</sup> provides an example of companies that follow a strategy for achieving competitiveness through optimising the production in the entire - international - value chain. Some companies have outsourced the main parts of their production, making increased use of (international) subcontracting, and at the same time domestic production has focused on developing business activities such as design/product development, sales and marketing (market analysis) even by gaining access to the market through own shops both on the domestic market and on the international market. The main focus of such enterprises is to obtain a powerful competitive position in the value chain. In other words, the survival of enterprises is not only a question of being competitive in economic terms. The control of information, knowledge, technology and capital and competence to run an international business also has considerable influence on a company's ability to compete successfully on the international market.

A Swedish study<sup>6</sup> of the huge forest industry shows a similar tendency to assign a more important role to subcontractors both quantitatively as a share of turnover and qualitatively by giving responsibility for new product areas. The buying enterprises demand that their key suppliers have a broad net of contacts for improving technological and market knowledge. This can contribute to positive business dynamics with the subcontractors actively developing new ideas and products that are complementary to the existing production of components.

Many SMEs, in almost all industrial sectors, now face increasing competition due to internationalisation. SMEs have to respond strategically to these challenges whether they find themselves in 'protected' national market niches or are heading for a committed international strategy. There is a danger that SMEs will only have sufficient competitive power to take secondary and not leading positions in the value chain, thereby bringing SMEs' profit to a minimum level. For instance, the Portuguese textiles and clothing industry, compared to the Danish textile industry, has met increasing competition as manufacturers and are now fighting for a new international position in the value chain.

In order to face these challenges, the SMEs need to be aware that increased competition seems to be rooted in an inward-outward perspective. They need to pay attention to the following:

- Global differences in production conditions (e.g. labour costs) are exploited more effectively;
- Innovative capability and ability to develop and absorb new technology;
- Knowledge of the market;
- Access to capital;
- Dominating statuses in the hierarchy of companies.

The development of external relationships is becoming a key instrument in the internationalisation process even for SMEs; e.g. sales offices abroad, networks (tight subcontracting relationships; even though there is a tendency to reduce the number of main subcontractors), development of international company groups etc.

In other words, there is a need for a more holistic approach to the analysis of internationalisation processes, since these are much broader than a mere ambition to sell products in a foreign market.

## 1.2. Objectives and main research questions

The aim of this report is to verify that SMEs are involved in internationalisation in a much more complex manner than as mere exporters. The report will analyse how SMEs are involved in the international activities with special focus on:

- The pattern of internationalisation among SMEs;
- The motives for internationalisation;
- The impact of internationalisation on competitiveness;

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5 The Danish Ministry of Economic and Business Affairs, *Handels erhvervet - tendenser, nye roller og udfordringer* (The Trade Industry - trends, new roles and challenges), Copenhagen, 2001.

6 Karlsson, S. Nedomysl and Nordström: *More than a lot of paper! - Innovations and development within Värmlands' Forest industry cluster, Verket för innovationssystem* (Swedish Agency for Innovation System), Sweden, 2001.

- How SMEs are managing internationalisation, including an analysis of the internal and external problems that SMEs face in the internationalisation process.

Policy measures will be studied as a response to the problems faced by SMEs in the internationalisation process. The key question is whether the SME policy reflects the new holistic approach to internationalisation.



# Chapter 2

## Different forms of internationalisation

### 2.1. Introduction

As a point of departure for understanding the internationalisation of SMEs, this chapter will give an overview of the actual status of the internationalisation of SMEs.<sup>7</sup> For this purpose, the chapter will investigate the activities adopted by SMEs in order to internationalise.

As discussed in Chapter 1 internationalisation no longer has a limited focus on exporting, but has become a much more differentiated business activity encompassing trade, cross-border clustering, cross-border collaboration, alliances or subsidiaries, branches and joint ventures abroad.

The final section in this chapter presents a discussion of the pattern of internationalisation or the pace at which the internationalisation comes about in the SMEs.

The analyses and data presented in this chapter are, to a great extent, based on the results from the ENSR Enterprise Survey of 2003. (See Annex II to this report: The set-up and analyses of the ENSR Enterprise Survey 2003). National and international studies will be included to a greater extent in the following chapters.

The report will focus on investigating how SMEs with different types of international activities also differ with respect to size and sector or how they perceive drivers and barriers to internationalisation.

Respondent SMEs of the ENSR Enterprise Survey have therefore been grouped into four mutually exclusive categories, according to their different internationalisation profiles:

- 1 Foreign supplier (importing) as the only form of internationalisation;
- 2 Exporting as the only form of internationalisation;
- 3 Subsidiaries, branches and joint ventures abroad, or a combination of more than one form of internationalisation;
- 4 Non-internationalised SMEs.

Group 3 consists of SMEs with more complex international activities than merely importing or exporting.

The group of 'non-internationalised' SMEs as defined in this report covers the SMEs that neither export nor have foreign suppliers, subsidiaries, joint ventures or branches abroad. It is thus defined as a residual group of SMEs that have no cross-border activities demanding actual trade or active entry into a foreign market. However, as it will be stressed throughout the report, the concept of internationalisation is not to be restricted to just trade or foreign subsidiaries, but rather it must be viewed in a broader sense encompassing networking and informal co-operation with foreign companies.

The three groups of internationalised SMEs may represent different strategic approaches to internationalisation, but they may also - in some cases - represent different stages of an ongoing internationalisation process.

This chapter will first focus on exports and describe differences in size and industrial sectors as well as cross-country differences. Afterwards, collaborative approaches to internationalisation will be studied. In this chapter it will be established that co-operation and alliances across borders are increasingly frequent among SMEs as part

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<sup>7</sup> For some general data on SMEs in Europe, see Annex I to this report: The position of SMEs in Europe-19.

of the global restructuring process and in order to allow exchanges of know-how and technology as a way to achieve competitiveness.

## 2.2. A differentiated internationalisation profile of SMEs

To begin with, the survey results provide a general picture of the prevalence of different types of internationalisation among SMEs in the EU. An initial overview is given in Table 2.1 presenting the frequency of some main forms of internationalisation. Note that one SME may figure in several categories.

**Table 2.1: Frequency of different types of internationalisation**

Type of internationalisation	Percentage of total SMEs
Foreign supplier (importing only)	30 %
Exporting only	18 %
Collaboration, primarily with foreign SMEs	3 %
Subsidiary, branch or joint venture abroad	3 %

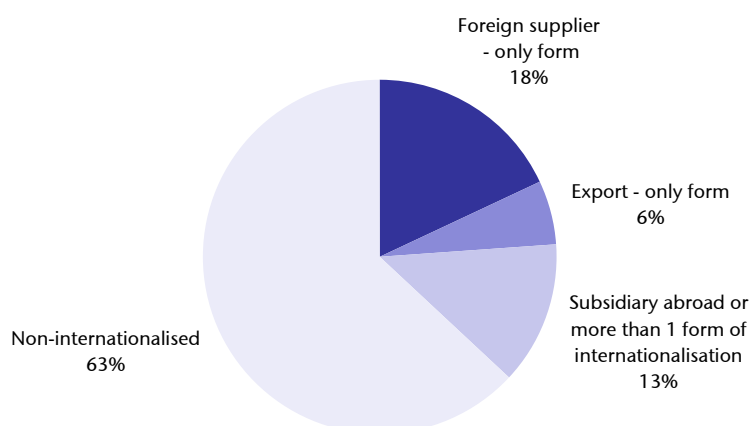
Note: The above percentages cannot be summed, since individual companies may figure in several categories.

Source: ENSR Enterprise Survey 2003.

Having a foreign supplier is the most frequent basic form of internationalisation, followed by exporting. Establishments or joint ventures abroad may be characterised as more complex internationalisation activities that are only undertaken by 3 per cent of the SMEs.

In Figure 2.1 the SMEs are divided into the four different, mutually exclusive categories of internationalisation presented in Section 2.1. This gives some additional information on the internationalisation strategies of SMEs.

**Figure 2.1: The prevalence of different forms of internationalisation among SMEs**



Source: ENSR Enterprise Survey, 2003.

Of all SMEs, 18 per cent use only import, without exporting or having foreign establishments. Another 12 per cent have imports in combination with export or foreign subsidiaries. Hence, of the 13 per cent in the group engaging in more complex forms of internationalisation, almost all have a foreign supplier.

An interesting finding is that exports seem to be much more frequently combined with a foreign supplier than as an isolated activity. Only 6 per cent have just exports, but 10 percent of SMEs have both foreign suppliers and exports. This might indicate that having a foreign supplier somehow supports or promotes export-related activities. This hypothesis is supported by a Dutch study showing that importing SMEs are prompted to export by the fact that they are trading with foreign firms.<sup>8</sup>

<sup>8</sup> Elk, J.W. van, Overweel, M.J., Met Kracht Naar Het Buitenland (Full speed abroad), ABN-AMRO Bank, Amsterdam, 1991.

Co-operation with a foreign SME as the most important partner is undertaken by 3 per cent of the SMEs in the ENSR Enterprise Survey, as shown in Table 2.1. Another 6 per cent have important partners both nationally and abroad. Co-operative approaches to internationalisation may, however, be of even greater importance than indicated by the survey. The survey enquired into the extent of co-operation among SMEs, but some respondents may have distinguished between having actual co-operation activities and being involved in international networks. The importance of network activities may be indicated by a Spanish study<sup>9</sup> of panel data from 963 SMEs concluding that commercial networks abroad are more frequent among SMEs than exporting. Networking activities are reported to be undertaken by 53 percent, mostly micro enterprises, whereas 50 percent export.

Another form of internationalisation, not investigated in the ENSR survey, is indirect exporting, e.g. when the enterprise supplies a market abroad via an intermediary domestic company, e.g. a wholesale company. A Finnish survey<sup>10</sup> of 270 SMEs with some international activities revealed that 40 percent had indirect exports (compared to 84 percent with direct exports). These forms of internationalisation are not easily identifiable in the general statistics. However, an attempt has been made to measure this source of indirect exports in European SMEs in one of the Observatory's reports in 2002.<sup>11</sup> In that study, the contribution of indirect exports to the real turnover growth from 1988-2001 was found to be 10 percentage points less than the contribution of direct exports of 14 percentage points. The total turnover growth for SMEs being estimated at 34 percent, the indirect exports thus should account for almost one third of turnover growth in the period.

As can be seen in Table 2.1, only 3 percent of European SMEs reportedly have subsidiaries, branches or joint ventures abroad. Trade (and collaborative approaches or networks) are thus much more frequent than establishments abroad. The creation of subsidiaries abroad may, however, become more and more frequent among SMEs. A Swiss study<sup>12</sup> indicates that the share of micro-sized enterprises with subsidiaries abroad tripled between 1990 and 1998, whereas the corresponding share among large enterprises did not change significantly in the same period.

It is worth noticing that, according to the 2003 ENSR Survey, more than one third of the SMEs with subsidiaries abroad in the ENSR Enterprise Survey have no exports. This demonstrates that the creation of subsidiaries abroad is not merely a question of getting a sales platform for the company's products. Foreign subsidiaries can just as well be a platform for access to cheap labour (e.g. via sub-suppliers) or access to knowledge and technology. These figures indicate that SMEs have a differentiated approach to internationalisation where some SMEs try to optimise their competitiveness by exploiting new business opportunities in the value chain.

## 2.3. Smaller countries are more internationalised

The degree of internationalisation among SMEs varies substantially among the European countries. Figure 2.2 shows the total share of SMEs that have a foreign supplier and the total share of SMEs that have exports, from the various countries. Note that the categories in this figure are not mutually exclusive, since they cover all SMEs with either exports or a foreign supplier.

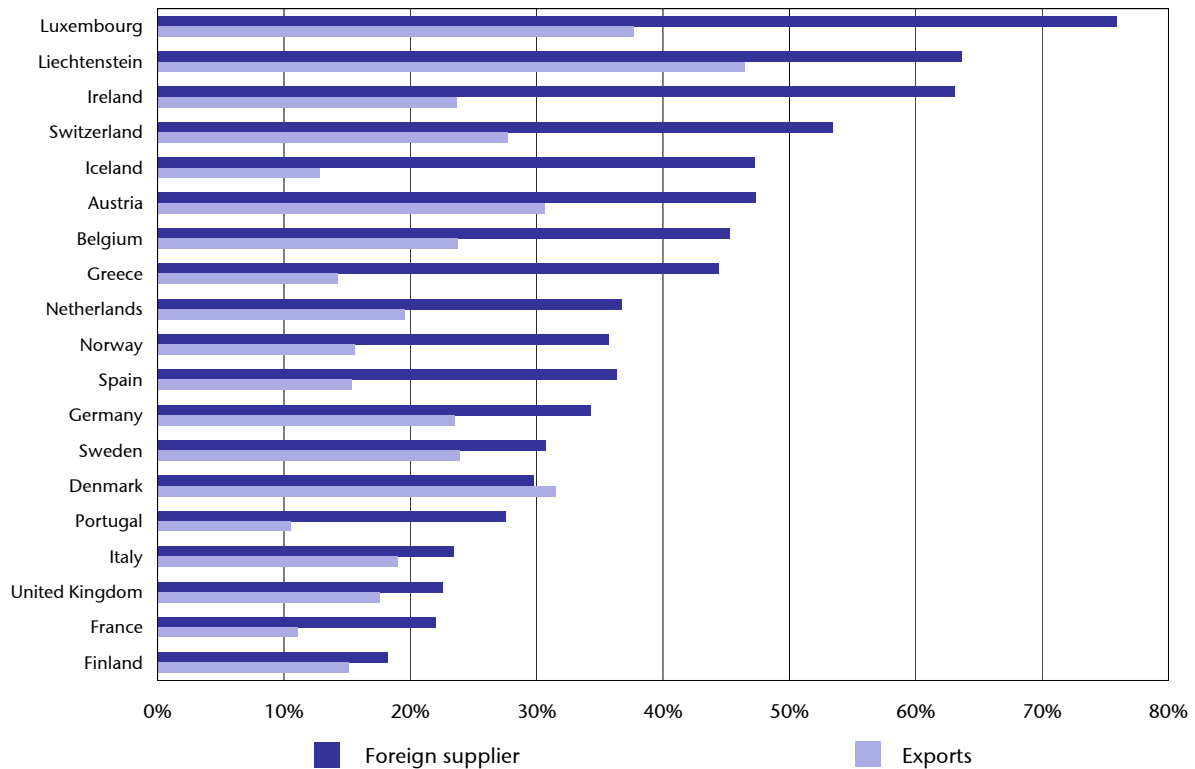
9 Merino de Lucas, F., El proceso de internacionalización de las pyme (The internationalisation process among SMEs), in Papeles de Economía Española, No. 89-90. Madrid, 2001.

10 Kailaranta, J., Kansainvälistyvän pk-yrityksen vahvuudet ja kehittämistarpeet (Strengths and development needs of internationalising SMEs), Ministry of Labour, ESF Publications 26/1998. Helsinki, 1998.

11 European Commission, The Observatory of European SMEs - 2002, No. 2, Luxembourg, 2002.

12 Avantis, S. et al., Die Internationalisierung der Schweizer Wirtschaft - Ausmass, Motive, Auswirkungen (The internationalisation of the Swiss economy - importance, motives and effects), Vdf Hochschulverlag AG an der ETH, Zurich, 2001.



**Figure 2.2: Percentage of SMEs with foreign supplier or exports**

Note: The categories are not mutually exclusive, since one SME may have both export and a foreign supplier.

Source: ENSR Enterprise Survey, 2003.

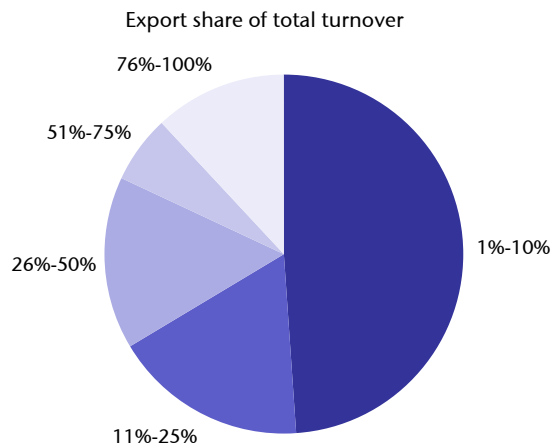
### Foreign supplier

The countries are ranked according to the share of SMEs that have a foreign supplier. The tendency is clearly that SMEs in small countries more often have foreign suppliers than SMEs in large countries. Similarly, SMEs in the central European countries (with many directly neighbouring countries) use foreign suppliers more frequently than SMEs in the Nordic countries.

### Exports

A high share of SMEs with foreign suppliers does not mean a high share of exporting SMEs. As can be seen from Figure 2.2, in four relatively small countries, more than 30 percent of the SMEs export (Liechtenstein, Luxembourg, Denmark and Austria). Of the nine most export oriented countries (with a share of more than 20 percent of exporting SMEs), Germany is the only large country. Several national studies (Braunerhjelm (2000), O'Malley and O'Gorman (2001), Elk and Overweel (1991))<sup>13</sup> stress that the size of the domestic market is a very decisive factor for internationalisation. SMEs with a specialised production or some large scale production very soon find that the demand on the domestic market is insufficient for building a sound business. Tendencies towards increasing specialisation will probably push an increasing number of SMEs into international business.

<sup>13</sup> Braunerhjelm P., Knowledge Capital and the New Economy - Firm Size, Performance and Network Production. Stockholm, 2000 O'Malley, E. and O'Gorman, C., Competitive Advantage in the Irish Indigenous Software Industry and the Role of Inward Foreign Direct Investment, in: European Planning Studies, Basingstoke, 2001 and Elk, E., and Overweel, M.J., Met Kracht naar het Buitenland, (SME: Full speed abroad), Amsterdam, 1991.

**Figure 2.3: Export intensity of European SMEs**

Source: ENSR Enterprise Survey, 2003.

Figure 2.3 shows how the European exporting SMEs can be grouped according to their export share of total turnover.

First of all, it can be seen from Figure 2.3 that almost 50 per cent of the exporting European SMEs export 10 per cent or less of their total turnover. On the other hand, around 6 percent export between 50 and 75 percent of their turnover and around 12 percent export more than 76 percent. In total almost one-fifth (18 per cent) export more than 50 per cent of their total turnover.

An analysis of the export intensity per country reveals by and large similar profiles in the share of turnover that is exported. However, Finland and Liechtenstein stand out: 71 per cent of Finnish exporting SMEs export less than 10 per cent of their turnover. In Liechtenstein, 34 per cent of exporting SMEs export more than 50 per cent of the turnover.

#### Subsidiaries

When it comes to having subsidiaries or branches abroad, the country percentages are much lower than for export. Thus, for most European countries a mere 1-4 per cent of the SMEs have established subsidiaries abroad. In just three countries, the SMEs with subsidiaries abroad exceed 6 per cent of total SMEs: Switzerland with 7 per cent, Denmark with 9 per cent and Iceland with 11 per cent. This corresponds with the fact that these countries are small with very open economies.

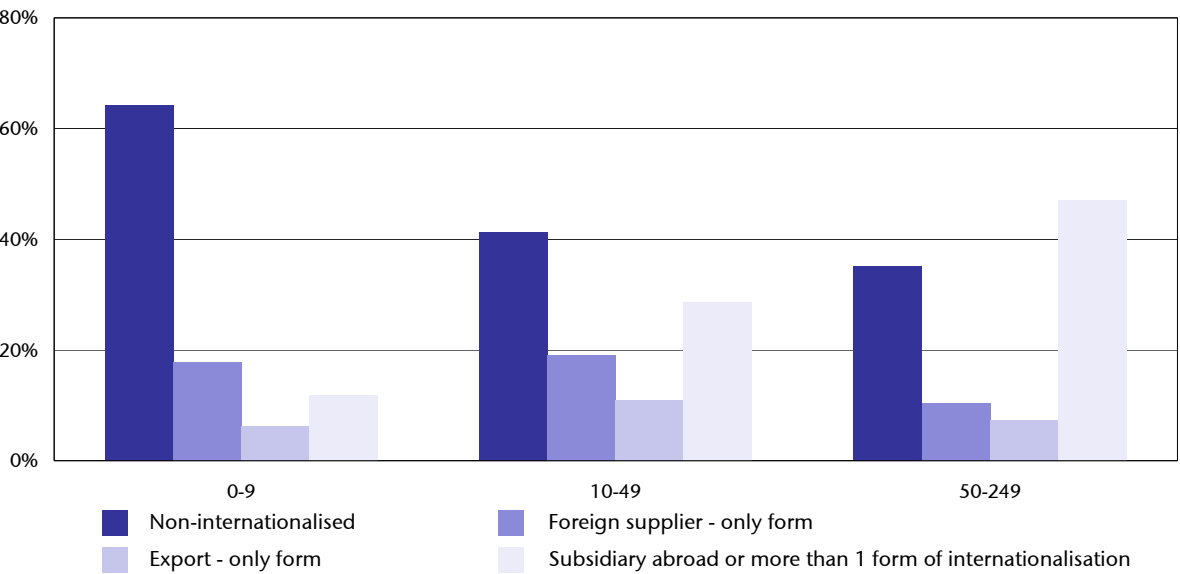
#### Inter-country relationships

The data from the survey also gives an overview of the most important inter-country relationships, taking into account both exports, foreign suppliers or subsidiaries and branches or joint ventures abroad. The data confirms that neighbouring countries still constitute the easiest and most frequent business partners. Apart from these and in general, the large markets for international business are the large European countries: Germany, France, Italy and Spain, and also the USA.

## **2.4. Larger companies are more internationalised**

The importance of company size is another interesting aspect of internationalisation, and as it can be seen from Figure 2.4, size still matters.

Figure 2.4: Frequency of internationalisation by size of enterprise



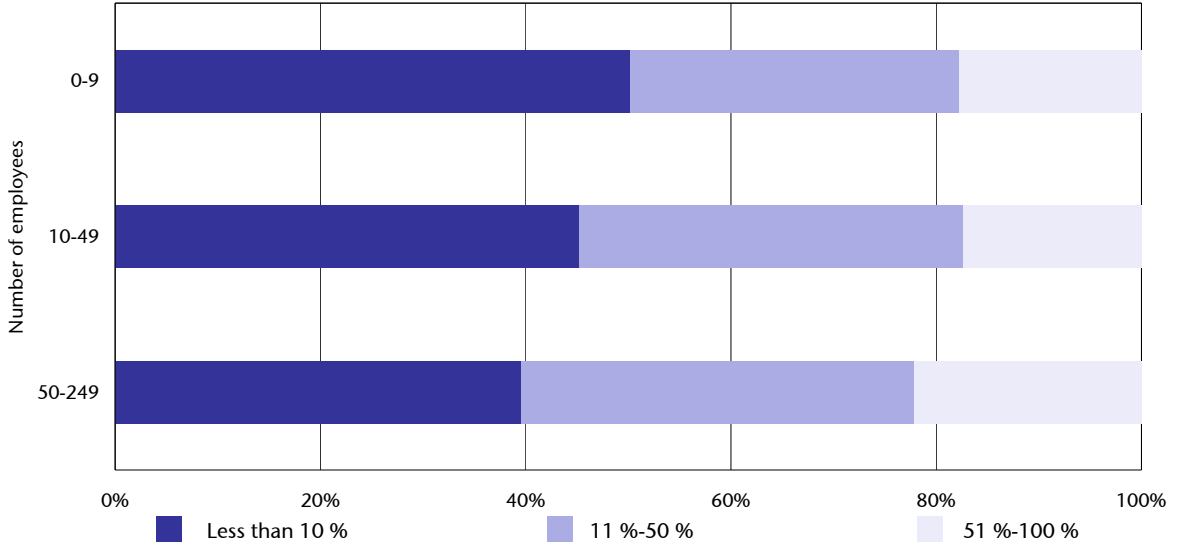
Source: ENSR Enterprise Survey, 2003.

Micro enterprises are significantly less internationalised than small or medium-sized enterprises. While 64 per cent of micro enterprises are non-internationalised, this is only true for 35 per cent of medium enterprises. The size difference is particularly marked when analysing the share of SMEs with more complex forms of internationalisation such as a subsidiary, branch or joint venture abroad or a combination of more than one form of internationalisation.

There are, however, also significant differences when it comes to having exports or not. The total share of micro enterprises with exports (alone or in combination with other forms) is 17 per cent, whereas the share is 38 per cent and 51 per cent for small and medium-sized enterprises respectively. Thus, the size of the enterprise seems to have a significant impact on the possibilities or choice of internationalisation.

Smaller companies thus export or create subsidiaries abroad less frequently. Moreover, smaller exporters seem to have lower export intensity on average, as shown in Figure 2.5.

Figure 2.5: Export intensity (export in % of total turnover) by size



Source: ENSR Enterprise Survey, 2003.

However, although the export intensity does differ between the micro and medium enterprises, the differences in export intensity between the size classes are less marked than the differences between the export frequencies of micro versus small/medium-sized enterprises, as reported in Figure 2.4. This indicates an interesting finding: the smaller the enterprise, the fewer the chances that the enterprise will undertake international activities (see Chapter 3), but when the enterprise first starts exporting, the smaller enterprises do on average export with almost the same intensity as larger enterprises.

This finding, that enterprise size and export intensity are not significantly related, is supported by a German econometric study.<sup>14</sup> This study identifies those factors that may relate to export success and that are found more often in larger enterprises rather than smaller ones. When controlling for these success factors, which are positively correlated with enterprise size, the result is that size as such does not contribute to a higher export share.

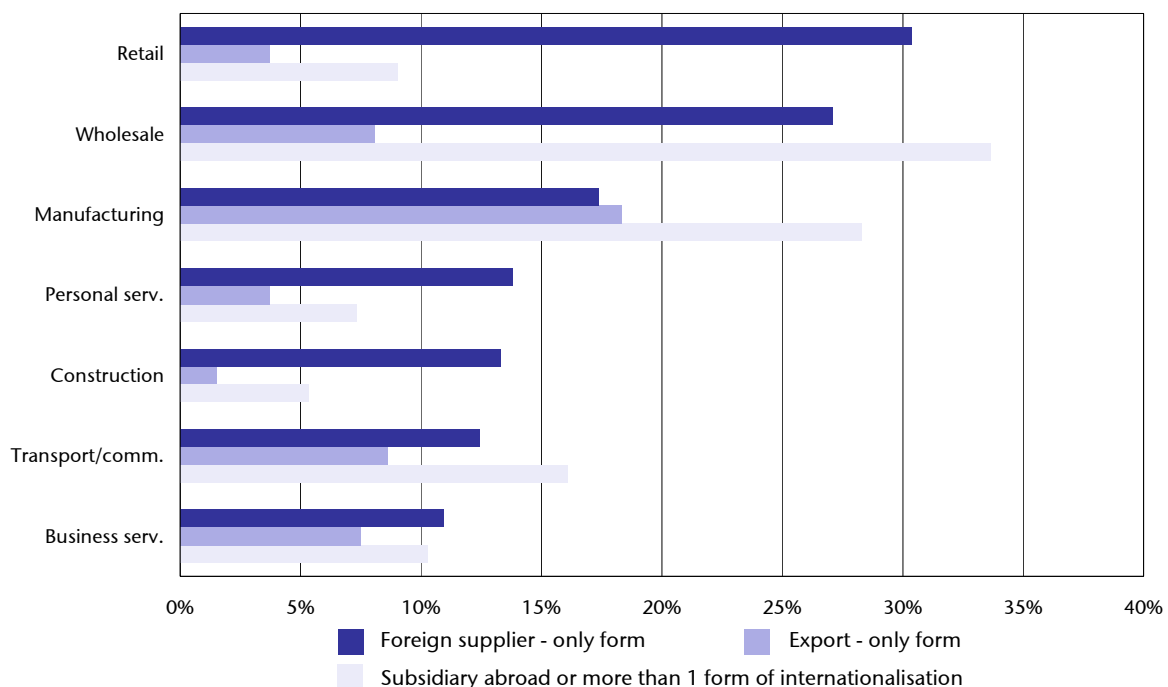
## 2.5. Both manufacturing and service are internationalised

Different business sectors will naturally be internationalised to different degrees and in different ways, due to their different activities. For instance, whereas exports might be expected to be common within the wholesale sector, it is, by tradition, less common in construction. However, some business service sectors such as software design, accounting, legal services, consulting etc, although traditionally domestically oriented, may be increasing their international activities. In the following paragraphs it will be analysed to which extent such tendencies can be seen in the internationalisation statistics of the different business sectors.

Figure 2.6 shows the percentage of SMEs that export and the percentage with subsidiaries abroad for the different industrial sectors.

In Figure 2.6, the business sectors are ranked according to the share of SMEs with a foreign supplier as the only form of internationalisation. This is clearly most frequent within retail (30 %) and wholesale (27 %). However, it is also evident that other forms of internationalisation (e.g. subsidiaries) are most frequent within manufacturing and wholesale.

**Figure 2.6: Internationalisation in different sectors**



Source: ENSR Enterprise Survey, 2003.

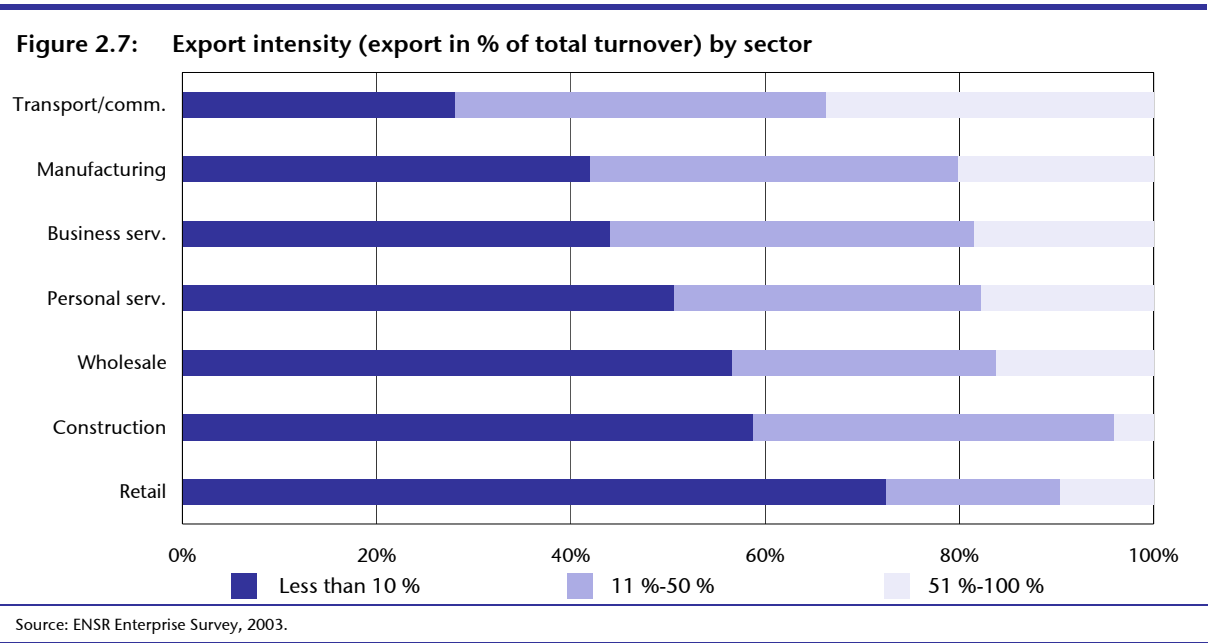
<sup>14</sup> Wagner, J., Unobserved firm heterogeneity and the size-exports nexus: Evidence from German panel data, in: Hamburgisches Welt-Wirtschafts-Archiv (HWWA) (ed.): HWWA Discussion Papers, No. 194, Hamburg, 2002.

Within these two sectors and transport/communication, the percentage of SMEs that have subsidiaries or more than one form of internationalisation is actually higher than the percentage that merely has a foreign supplier or that exports as isolated forms of internationalisation. This could indicate that different internationalisation activities within these sectors support each other.

The same three sectors, manufacturing, wholesale and transport/communication also have the highest propensity to export (whether as a sole form or in combination with other forms). The propensity to export for the wholesale trade sector is actually higher for SMEs than for larger enterprises, according to one of the Observatory of European SMEs' reports (2002).<sup>15</sup> This is explained by the fact that LSEs and SMEs tend to engage in different activities within the wholesale trade sector. SMEs more often focus on trade activities whereas LSEs focus on distribution.

On the other hand retail is among the least export oriented sector. However, it is worth noticing that all in all, more than 10 per cent of the SMEs within retail actually do export, although retail traditionally has been a very locally based sector.

What is the situation when considering export shares of total turnover across sectors? When considering only the companies that export, do some sectors have higher export shares than others? In Figure 2.7, the export intensity (for those SMEs that export) is illustrated for the different industrial sectors.



The transport & communication sector is clearly the one with the highest export intensity, with 32 per cent of the exporting SMEs exporting more than 50 per cent of their turnover. Conversely, retail is the sector with the lowest export shares for exporting companies - for 71 per cent, the export amounts to less than 10 per cent of their turnover - followed by construction with 58 %.

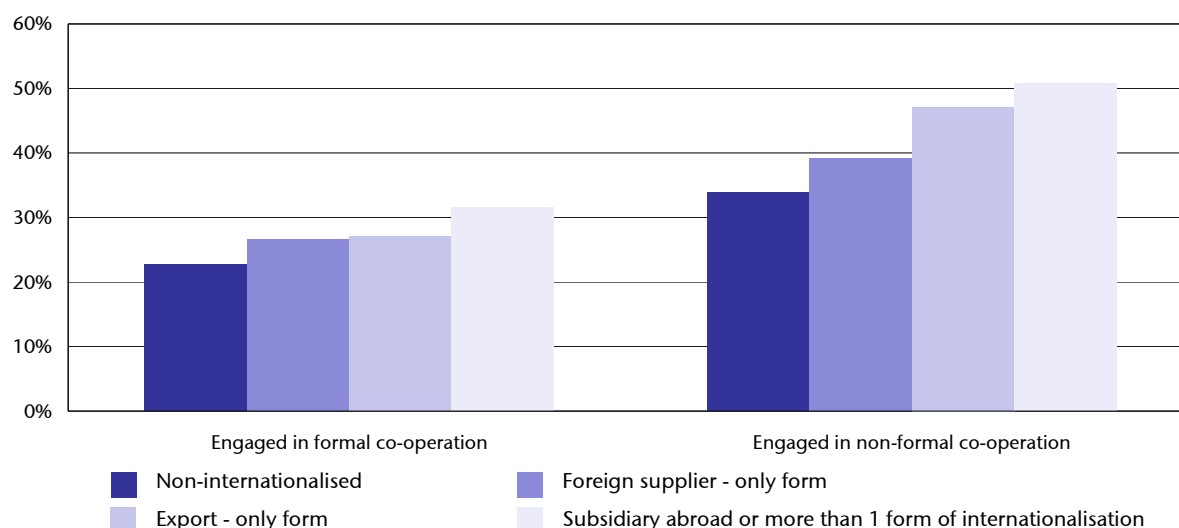
When comparing Figure 2.6 and 2.7, another finding appears. The share of exporting enterprises differs considerably between the industrial sectors - with manufacturing industries as the most export-oriented - but once the enterprises have entered the international market, the export intensity profile for industries such as manufacturing, business service and personal services is almost the same.

<sup>15</sup> European Commission, The Observatory of European SMEs - 2002, No. 2, Luxembourg, 2002.

## 2.6. Collaborative approach - alliances, networks and FDI

Internationalised SMEs collaborate more frequently, whether as formal or non-formal co-operation, than SMEs in general.<sup>16</sup> This can be seen in Figure 2.8. Moreover, the more complex or outgoing the internationalisation activities of the SMEs are, the more often they co-operate with other SMEs as well.

**Figure 2.8: SMEs in formal and non-formal co-operation**



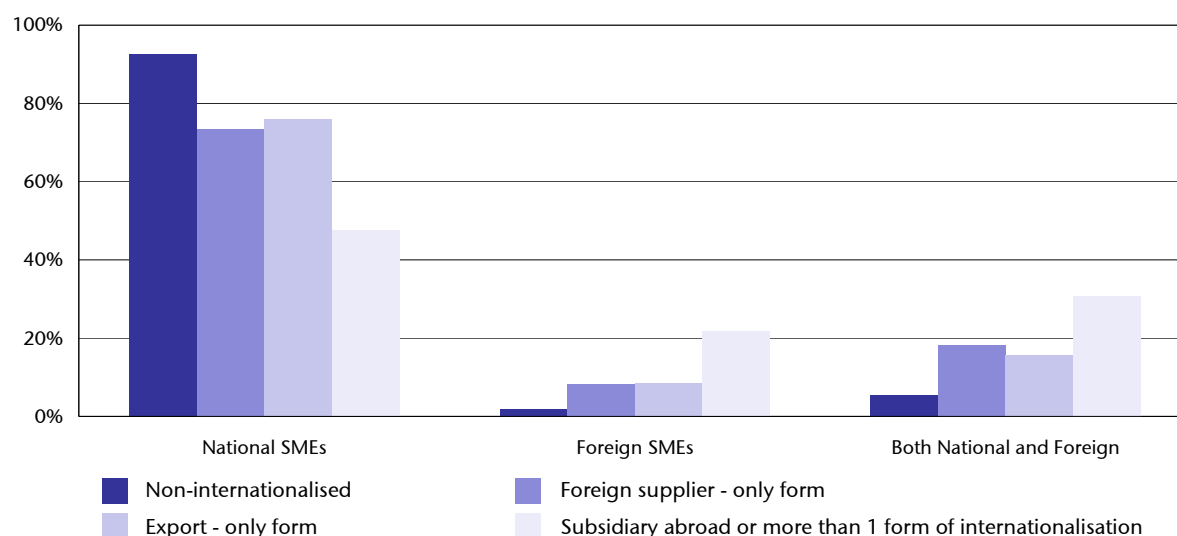
Source: ENSR Enterprise Survey, 2003.

Among the SMEs with subsidiaries or branches abroad or more than one form of internationalisation, 32 per cent engage in formal and 51 per cent in non-formal co-operation.

In Table 2.1 above, it was reported that only 3 per cent of SMEs collaborate with foreign SMEs. However, if we look at internationalised enterprises, the picture is different, as illustrated in Figure 2.9.

For the internationalised enterprises, collaboration with foreign enterprises or partners is more frequent. Among the SMEs with subsidiaries abroad or more than one form of internationalisation, 22 per cent of those cooperating with other SMEs directly have foreign partners and 31 per cent have both foreign and national partners of importance.

<sup>16</sup> Co-operation for a common purpose between independent SMEs goes over a longer time period and has a wider scope than one single task or one single purchase. Formal co-operation is regulated by an agreement or contract, while the terms of non-formal co-operation are not specified in a written document, but based on verbal agreement, on previous experience or simply on trust.

**Figure 2.9: National or foreign SMEs as important partners in cooperation**

Source: ENSR Enterprise Survey, 2003.

### Alliances

A great deal of the formal co-operation between SMEs is likely to be in the form of alliances<sup>17</sup> and networks. Alliances with larger enterprises or even multinational enterprises (MNEs) are, however, also an important way of internationalising for SMEs.<sup>18</sup>

Evidence in international literature indicates that alliances are of increasing importance. Intensified international competition drives companies to specialise and concentrate on their core competencies. Larger companies increasingly outsource all other activities, which brings SMEs into play. Following the same line of reasoning, MNEs also form alliances with SMEs to gain market insight into a particular national market.

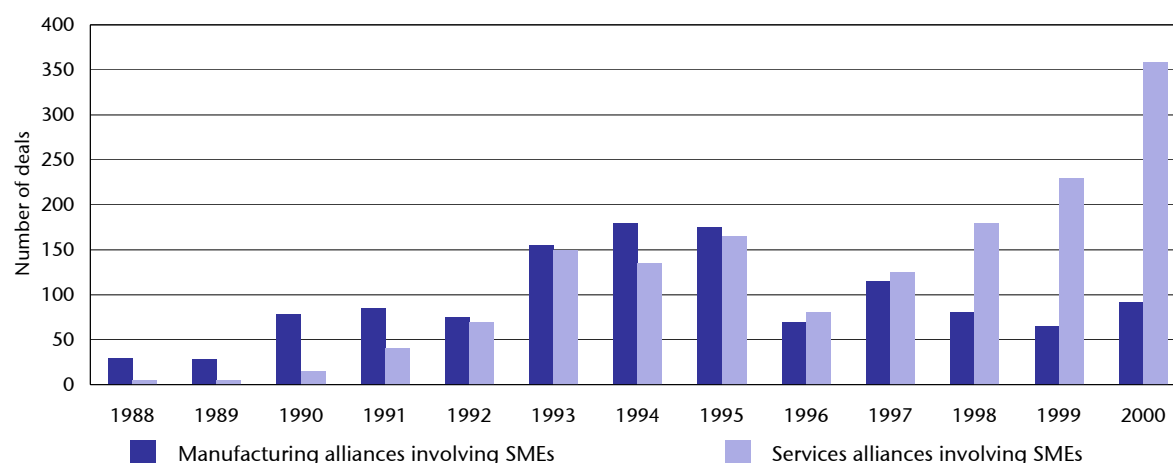
Studies also point to an increased growth in alliances globally as a result of an increasingly knowledge-based economy.<sup>19</sup> One of the important effects of the growing emphasis on knowledge management is a renewed focus on core competence. This focus on core competence leads to a trend of de-internalisation, where non-core activities are placed outside the enterprise itself. This naturally creates a corresponding rise in outsourcing alliances.

An estimate of the total number of alliances involving SMEs from 1988 to 2000 was presented in the OECD Small and Medium Enterprise Outlook 2002 and is reproduced in Figure 2.10.

17 Strategic alliances are co-operative arrangements between independent firms based on business contracts to enhance the competitive strategies of the participating enterprises (OECD, Global Industrial Restructuring: Implications for Small Firms, OECD Working Paper 2002/4 by Kentaro Sakai, February 2002).

18 OECD, Global Industrial Restructuring: Implications for Small Firms, OECD Working Paper 2002/4 by Kentaro Sakai, February 2002.

19 Contractor, F.J. & Lorange, The growth of alliances in the knowledge-based economy, International Business Review 11, 485-502, Pergamon, 2002.

**Figure 2.10: Cross-border alliances involving SMEs, 1988-2000**

Source: OECD Small and Medium Enterprise Outlook, 2002.

Alliances and networks can relate to joint research and development, manufacturing, marketing, sourcing of inputs, or co-operation on distribution. Alliances can also be an important source of indirect export, for instance when SMEs trade their products internationally via a larger domestic trading company.

Figure 2.10 shows first of all that alliances involving service companies have increased significantly and constantly since 1996. Alliances within manufacturing seem to have stabilised on a much lower level during the same period. There are two important notes to this development as presented: first of all, the real number of deals regarding alliances has probably been much higher. The statistics (based on Thomson Financial database) only register alliances made public in national or international media. However, many alliances, particularly among small enterprises, do not get such exposure. Secondly, although definite data is not yet available, the rate of formation of alliances will probably have decreased significantly during the last years 2001, 2002 and in the first half of 2003, due to the general economic instability and the downturn of the stock markets.<sup>20</sup>

### Foreign direct investment

The establishment of a subsidiary or branch abroad requires foreign direct investment (FDI). The amount of FDI thus describes a significant form of internationalisation. No statistical figures have been found about FDI by SMEs in particular, but the general picture is that FDI in Europe increased continually during the 1990s. However, recent data show a clear, decreasing tendency in the FDI flows from 2000 to 2002.

The analyses by the OECD explain this decrease by the unsettled international political and security environment during 2001 and 2002, an insecurity that actually continued in the first half of 2003. According to the OECD,<sup>21</sup> the marked slowdown of flows at the beginning of the new decade mostly reflected a correction to sustainable levels rather than a reversal of a trend. Thus, the importance of cross-border ownership of assets continues to increase, mirroring the substantial role of internationally oriented enterprises in the global economy.

All in all, the figures presented in this chapter indicate very clearly that internationalisation is a much more diversified business activity than just exporting or establishing a subsidiary abroad. Besides approaching a foreign market, the internationalised SMEs also have the opportunity to utilise their access to a much more diversified 'market' for qualified partners e.g. for technological collaboration (access to new technology or knowledge) or low cost and/or specialised sub-suppliers. These figures indicate that internationalisation is also a matter of prof-

<sup>20</sup> This has been the case for the number of mergers and acquisitions, which, according to the OECD was historically modest in the first five months of 2003 (only half of the activity compared with the year before). The trend in mergers and acquisitions may give a rough indication of the trend in alliances since both types of activities require confidence in the economy of the partner-country, and they are therefore both sensitive to international economic instability. (OECD Trends and recent developments in foreign direct investment, by Hans Christiansen and Ayse Bertrand, June 2003.)

<sup>21</sup> OECD Economic Outlook No. 73, June 2003.



iting from broader access to partners and suppliers in the value chain, which in the end contributes to increasing competitiveness and productivity<sup>22</sup>.

## 2.7. From internationalisation in stages towards a comprehensive view

Do different types of internationalisation represent stages of a unique process, or do they represent strategic choices by SMEs that differ in their structure, activity and functioning?

### The Stage Theory

A prevailing model of the internationalisation process is the Stage Theory, according to which internationalisation takes place in progressive stages, moving from low commitment/risk to high commitment/risk:<sup>23</sup>

- 1 No regular export activities (perhaps sporadically occurring export);
- 2 Export via independent representatives;
- 3 Establishment of own sales subsidiaries abroad;
- 4 Production facilities abroad.

The rationale behind this model is that a progressive strategy minimises the risks and investment amounts required at one point in time. Typically, enterprises start by exporting to markets within little geographic distance. Once they have gained experience from these initial export activities, they then expand their export activities to more distant markets.

This dynamic perspective of the internationalisation process as a series of consecutive steps during which firms gradually become more experienced is supported by both some national studies of SMEs (e.g. from Iceland<sup>24</sup> and Spain<sup>25</sup>) but also in the cross-national *Interstratos* study of SMEs from 1993.<sup>26</sup> This study, however, also found that a substantial group of SMEs seemed to stagnate, to limit themselves from proceeding to a committed involvement stage. Others leapfrogged from one of the first stages to one of the last, and therefore clearly did not follow a gradual process.

Other studies also find evidence against the Stage Theory, e.g. a Norwegian study of longitudinal panel data concluding that more than 40 per cent of internationalised SMEs follow a discontinuous development pattern inconsistent with the Stage Theory.<sup>27</sup>

More recent literature points to a fundamental inconsistency between the Stage Theory and the empirical reality of a growing number of firms which adopt a global focus since their conception.<sup>28</sup> Such firms are often referred to as 'born globals'.

### Born Globals

Born globals are defined as companies that set up their activity targeting a market that is either global by nature or within a niche field that has a very limited potential on the domestic market. They often begin exports within the first five years of existence.

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22 Joseph Prokopenko: Globalisation alliances and networking: A strategy for competitiveness and productivity, International Labour Organisation, Enterprise and Management Development Working Paper - EMD 21/E, 1997.

23 Gankema, H.G.J., Snuif & van Dijken, The Internationalisation Process of Small and Medium Sized Enterprises: An Evaluation of the Stage Theory, 185-199, in Entrepreneurship and SME Research: On its Way to the Next Millennium, eds. Donckels R. & Miettinen, Aldershot, 1997.

24 Jónsdóttir, Einarsson, et al., Könnun á notkun íslenskra útfutningsfyrirtækja á Internetinu. Meistararnám í Viðskipta og hagfræðideild. (A survey of Icelandic export companies' usage of the Internet), MS student research paper, Department of Economics and Business. University of Iceland, Reykjavík, 2001.

25 Pla Barber, J., Un análisis empírico de la internacionalización española. Modos de entrada y factores de empresa, (An empirical analysis of Spanish internationalisation. Entry patterns and enterprise factors), Acade National Annual Congress, Las Palmas de Gran Canaria, 1998 and Merino de Lucas, F., El proceso de internacionalización de las pyme (The internationalisation process among SMEs), in Papeles de Economía Española, No. 89-90. Madrid, 2001.

26 Gankema, H.G.J., Snuif & van Dijken, The Internationalisation Process of Small and Medium Sized Enterprises: An Evaluation of the Stage Theory, 185-199, in Entrepreneurship and SME Research: On its Way to the Next Millennium, eds. Donckels R. & Miettinen, Aldershot, 1997.

27 Havnes, P. & Hauge, E., Utvikling i regional maritim næring - internasjonalisering av leverandørbedrifter (Development of regional maritime sector - internationalisation of suppliers) FoU-rapport Nr. 1/2002.

28 Etamad, H. & Wright, Internationalisation of SMEs: Toward a New Paradigm, Small Business Economics 20, the Netherlands, 2003.

According to a Finnish study among new enterprises in the metal industry and services, one in ten enterprises were born global in the sense that the existence of the company depended on exports.<sup>29</sup> Particularly within innovative technology sectors, new types of products and markets tend to make for rapid progress into the international arena. Studies<sup>30</sup> point to a significant number of born global firms operating in the industries that may be characterised as knowledge-intensive.<sup>31</sup>

### The holistic approach

Different theories so far would thus suggest that some types of SMEs tend to internationalise rather progressively, following a tentative and cautious process, whereas other types of SMEs may be born globals and be oriented towards internationalisation in an early stage of the enterprise.

However, the distinction between the Stage Theory and the born global model may be too rigid and may even lose relevance over time. This can be argued in different ways.

Firstly, the internationalisation process in SMEs may represent a mix of the different models. For some born globals, internationalisation is also gradual, but follows a compact, rapid progress. For others, the internationalisation process may be gradual and slow until a redefinition of the strategy and core activity would reclassify them as new, born globals, or 'reborn' globals.

Another reason why the distinction between gradual internationalisation and born globals may become inappropriate is if internationalisation has come to signify a whole palette of cross-border activities mutually supporting each other. When the international activity is driven by a need for access to know-how, technology or labour, the strategy will often be to engage in cross-border cooperation and networks, foreign suppliers and perhaps alliances or joint ventures, as much as simply exporting or creating subsidiaries. Thus, the different types of internationally oriented activities may be needed in combination rather than be successive stages in a gradual process.

Finally, as indicated by the various studies that have been referred to above, the different forms of internationalisation (trade, co-operation or FDI) may be undertaken rather more in response to different strategic goals than as stages in a gradual process. For certain types of service companies (e.g. consultancy firms, software developers, firms of architects etc.), it may be a more pertinent strategy to set up an alliance or joint venture with a foreign company straight away, rather than to pass by a stage of direct export. This is typically the case if the company is going international in search of know-how or technology. An example of this development is the Irish-Finnish case of SUPAPOW presented in Textbox 2.1.

#### **Textbox 2.1 SUPAPOW (Irish-Finnish) - Joint venture to combine different value chain competences**

POWEX is a Finnish company that develops and manufactures monitoring and control equipment for the energy production and distribution industry. They wanted to develop equipment capable of directly measuring the electric current flowing through overhead power lines. They had an idea for this equipment that revolved around ultrasound ranging technology, and in order to proceed with the project they wanted to find a partner with expertise in that technology.

SUPERULE Systems is an Irish company with expertise in the appropriate technology. SUPERULE Systems also had an international marketing network - with agents in North America, Asia and Australia - for its existing products.

When SUPERULE was contacted by POWEX, who had the idea to develop the new product, they took a significant new step by agreeing to create an international joint venture, named SUPAPOW. SUPAPOW was the first Irish-Finnish joint venture, and it was established in Ireland to develop and manufacture the new product. The joint venture agreement also gave POWEX access to SUPERULE'S international marketing network.

Source: IRC Network, Joint Venture Company to Manufacture Electrical Monitoring Equipment, 2003.

29 Littunen, Hannu, Uusien yritysten menestyminen. Osa IV: Yritystoiminnan vakiintuminen (The success of new firms - part IV stabilisation stage), Economic Research Center of Central Finland, Publications 140, Jyväskylä, 1997.

30 Saarenketo, S. & Sundqvist, S., Comparison of born global and traditionally internal firms: effects of industry and managerial characteristics. In (Saarenketo) Born globals - Internationalisation of small and medium-sized knowledge-intensive firms, Acta universitatis Lappeenrantaensis 145. Lappeenranta, 2002.

31 Knowledge-intensive industries include e.g. Electrical & Optical products, Office equipment, Other electrical appliances, Radio & TV equipment and Telecommunications equipment.

Therefore, a more holistic view of the internationalisation process might be introduced. Such a holistic approach could see to the different forms of international activities as a comprehensive set of internationalisation options open to the SMEs, demanding careful and individual strategic consideration as to which option, or combination of options, that will be the optimal choice at a given point in time.

The results from the ENSR survey, that one third of the SMEs with subsidiaries have no exports, is another indication of the fact that exports may no longer be the logical first step to internationalisation. A German study also shows that the different forms of internationalisation may be undertaken quite independently<sup>32</sup>. In this study, almost two thirds of internationally active SMEs pursue a one-dimensional internationalisation strategy, i.e. they focus exclusively on one form of international activity (only foreign trade, only co-operation or only foreign direct investments). One third has chosen a multi-dimensional internationalisation strategy: 23.7 per cent make simultaneous use of two forms and 10.4 per cent employ all three forms of international activities.

However, when the lack of resources or know-how about internationalisation is limiting the SMEs, a gradual approach can still be the strategic solution for internationalisation. One example of gradual internationalisation by a born global is represented in the Finnish case study of Blancco in Textbox 2.2.

Blancco was typical in the choice of addressing neighbouring countries at first, by direct export, and gradually developing until a foreign subsidiary was created.

#### **Textbox 2.2 Blancco (Finland) - A Born Global with continually progressive internationalisation**

BLANCCO is a Finnish technical service company specialised in data security and particularly in data erasure applications. BLANCCO was created in 1997 by two university students. In its early days, the company operated as a part of a local business incubator. In 2001, the enterprise employed 13 people and had a total turnover of approximately 760,000 euros. Exports accounted for over 40 % of the annual turnover.

BLANCCO can be characterised as a 'born global'. Growth orientation had been a mindset for the founders from the very beginning of the company history. When the enterprise commercialised its first software application in 1999, it was sold and promoted mainly on the national market. However, BLANCCO quickly became a market leader and the founders realised that the real growth potential was on international markets. Furthermore, the founders were encouraged by the fact that data-erasing business was an emerging field and they had a pioneering role with only a few competitors globally.

##### **The phases of BLANCCOS internationalisation process:**

- 1 Direct exports. Initially, the enterprise focused on exports by contacting potential customers directly or indirectly via existing clients' business network in each target market. Dealer networks were first established in Scandinavia and Northern Europe but today cover approximately 20 countries in four continents. Thirdly, an important means for direct exports has been through the Internet.
- 2 License agreements. Later on, in certain markets like Japan, the company has agreed to license their product to a local distributor, who sells the product under a different label.
- 3 Co-operation. In addition, the enterprise has started to search for partners for their after-sales services (such as recycling). Several agreements have already been made in Finland but internationally the process is ongoing.
- 4 Foreign subsidiaries. Most recently, the company has started a series of expansions in its major markets by establishing several sales subsidiaries in different areas.

The future internationalisation strategy of BLANCCO includes a decision to focus first on countries with similar market qualities to Finland and to create country-specific strategies for each target market. As target groups they have selected early adopters among private and public organisations in which the protection of information is of crucial importance and possibly even required by law. From a marketing point of view, the strategy is to focus on brand-building in order to shift the competitive advantage from a pioneering role to that of a brand in the emerging market of data erasure business.

Sources: Nummela, Niina (2002) Controlling the growth of a Born Global. Case: Blancco, International Journal of Entrepreneurship and Innovation, Vol.3 No.2, 221-226.

32 Kokalj, L. and Wolff, Die internationale Wirtschaftstätigkeit kleiner und mittlerer Unternehmen im Lichte der amtlichen und nicht-amtlichen Statistik (The international business activities of SMEs in the light of the official and non-official business statistics), in: Institut für Mittelforschung (IfM) Bonn (ed.): IfM-Materialien, No. 153, Bonn, 2001.

# Chapter 3

## Drivers for internationalisation

### 3.1. Introduction

During the last decades, ongoing restructuring has characterised business development in almost all industrial sectors world-wide. The aim of this chapter is to study how the managers of SMEs have reacted to this restructuring, and which specific drivers and motives have forced SMEs to internationalise. This analysis can be a contribution to understanding and improving SME policy.

First, a main set of drivers for SMEs is centred on the ambition to improve the competitiveness of the company based on direct economic parameters such as market size and costs. SMEs with a focus on economies of scale can thus be motivated to internationalise in order to gain access to:

- **Markets** - by creating market diversification/growth, launching of new products or by increased international competition on the domestic market
- **Sub-suppliers** - driven by rationalisation of the production and a need to minimise labour costs

From this point of view, internationalisation is very closely linked to a value chain perspective: maximising returns and minimising costs in purchasing, production and sales.

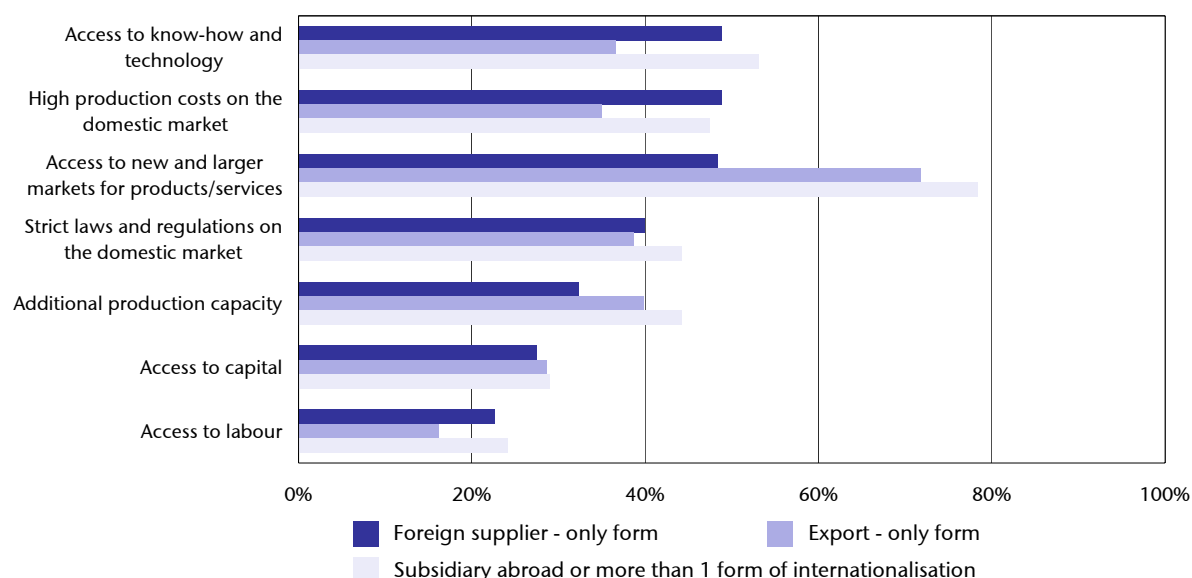
However, for some companies a second set of drivers exist, that are typically linked to a more strategic development of the company. In order to gain competitiveness, some companies strive to improve their innovative capability to introduce new products or services to the market. Some companies may also seek to obtain access to larger markets more indirectly via strategic collaboration. By utilising international resources, the SMEs may be able to fulfil this ambition by gaining access to:

- **International competences and resources** (technology, know-how, etc.)
- **International business relationships** which also include a learning element in terms of common R&D/innovation activities and by sharing knowledge
- **Finance/capital** from foreign markets

This chapter primarily analyses the main economic and strategic drivers as well as the company-related motives for internationalising, which are of great importance in order to understand the internationalisation of SMEs in a long-term perspective.

### 3.2. SMEs have various motives for internationalisation

Several different motives can be identified for the internationalisation of SMEs indicating a diversified approach to internationalisation. Figure 3.1 gives an overview of the importance of the different motives. The motives are ranked according to the responses given by SMEs with a foreign supplier as the only form of internationalisation.

**Figure 3.1: Motives for internationalisation**

Note: The graph represents the percentage that rated the motive 'important' or 'very important'.

Source: ENSR Enterprise Survey, 2003.

Access to new and larger markets is clearly the most frequent motive for internationalisation for the SMEs that export or have establishments abroad. This reflects the possibilities of expanding the market for a company's products by exporting or creating subsidiaries or joint ventures abroad.

For SMEs that have only imports, access to new and larger markets, is not a more frequent motive than access to know-how and technology or high production costs on the domestic market. This indicates, that the decision to actively go abroad does not simply arise as a subsequent stage to import (having a foreign supplier), but rather the different internationalisation types are related to different strategic goals.

However, it is interesting that access to new and larger markets is among the relatively popular motives for SMEs that only import. A robust explanation of the motive, however, is difficult, since the statement 'access to new or larger markets' can be interpreted in two different ways: the larger market may refer to the market for the company's own products or it may refer to the market for purchasing raw materials or other input products or services. For importers, the motive of access to larger markets may be different according to the interpretation of 'market'. Importing products, components or services may allow the company to gain larger market shares on the domestic market for its own products or, engaging in import of goods or services for production purposes may be a way to access larger input markets and thereby lower input prices.

#### Access to know-how or technology

It is interesting to note that access to know-how or technology is the most frequent motive for pure importers and the second most cited motive for SMEs with more complex forms of internationalisation. Also among SMEs that only export, more than one third do it - at least partly - to acquire knowledge. The decision to go international is thus not merely motivated by a potential to increase sales. The internationalisation is also an important means of gaining know-how and insight into new useful technologies as an input to strengthening the competitiveness of the SMEs.

The case of the Irish Dromkeen Food Ingredients (DFI) presented in Textbox 3.1 is an example of a manufacturing company that goes abroad to access new technological opportunities via a foreign partner.

**Textbox 3.1 Dromkeen Food Ingredients - Internationalisation to access know-how**

Brewer's yeast can be made into a range of food industry products, health and functional foods, and pharmaceuticals. Ireland has a substantial brewing industry, which produces a large amount of spent brewer's yeast. The Irish Dromkeen Food Ingredients (DFI) is an SME that uses this spent brewer's yeast to make yeast products for the food industry.

This is an example of the development of international technical and marketing co-operation. The managing director of DFI believed that the company could be making a lot of different products from yeast if it could get access to appropriate technology. In order to locate the required technology, it approached the Innovation Relay Centre (IRC) in Enterprise Ireland, which posted a technology request on the IRC network and helped DFI to assess the technology and negotiate the agreement that followed. Tas Consult of Antwerp in Belgium was found to have the required know-how. Tas Consult has developed processing technology to expand the range of products that can be made from brewer's yeast.

Under an agreement between the two companies, Tas Consult has transferred its technical protocols to DFI's manufacturing process and advised the company on adapting its plant to produce a wider range of products. The company's specialised knowledge of ingredients and strains of yeast has been a key factor in the agreement. Tas Consult is also advising on marketing the high added-value yeast products throughout Europe.

The main impact on DFI has been that it acquired new technology and began to produce new products. The company's sales increased. The two companies concerned went beyond what was originally envisaged to develop an ongoing working relationship, involving working together to locate new markets for niche products and to adapt their process to make them.

Source: IRC Network, New yeast processes make sales rise, 2003.

**Push or pull**

The access to new and larger markets motive, as perceived by the SMEs themselves, may actually correspond to one of two different types of more fundamental drivers for internationalisation:

- **Push drivers** - the domestic market is too limited for a highly specialised or niche product or the competition on the domestic market is too intense
- **Pull drivers** - typically when foreign buyers make unsolicited demands for a product, but also more frequently, a major customer requests that the company accompanies them onto foreign markets

Both types of drivers seem very common in most European countries. Studies from different countries often point to one or the other type of driver. The push driver of a limited home market is identified in Irish and Finnish studies.<sup>33</sup>

The pull driver has been identified as the most important in a Belgian study,<sup>34</sup> where 93 per cent of the surveyed SMEs indicated a request from foreign countries to be a driver for internationalisation, and a similar result was found in a survey from Luxembourg.<sup>35</sup>

The case of the French enterprise Mecaplan, presented in Textbox 3.2, is an example of an SME driven into export by its buyers.

33 O'Malley, E. & O'Gorman, C., *Competitive Advantage in the Irish Indigenous Software Industry and the Role of Inward Foreign Direct Investment*, European Planning Studies, Vol. 9, No. 3, Basingstoke, 2001 and Kailaranta, J. *Kansainvälistyvän pk-yrityksen vahvuudet ja kehittämistarpeet* (Strengths and development needs of internationalising SMEs), Ministry of Labour, ESF Publications 26/1998, Helsinki, 1998.

34 Donckels, R. & Aerts, R., *KMO's en internationalisering* (SMEs and internationalisation), Koning Boudewijnstichting in cooperation with the Small Business Research Institute and CERA, Brussels, 1992.

35 Centre de Promotion et de Recherche: *Investigation on the export activity and the participation in national and international fairs of companies belonging to the craft sector*, Chambre des Métiers du Grand-Duché de Luxembourg, Luxembourg, 1992.

**Textbox 3.2 MECAPLAN - A services provider that followed the customer abroad**

Since its creation, France's MECAPLAN has specialized in niche industrial, mechanical engineering for the heavy industry. MECAPLAN has 10 employees and has existed for 11 years. The company carries out studies and provides parts for elements of continuous production lines.

The buyers of MECAPLAN products are large groups from the steel industry, glass factories, cement works, power stations etc. These groups have all been internationalised and have factories world-wide. Therefore, MECAPLAN was driven to export in order to be in business with the large international groups.

The strategy adopted by MECAPLAN was to work for the French factories initially, and to use these references for the foreign factories of these groups. This strategy is still applied but references from these foreign factories have given the firm its own credibility, country by country. Thus, the domestic based buyers have been used as a link to establish export to the foreign factories that are however subsequently dealt with directly by MECAPLAN. Exports presently represent 80 % of the turnover

The dispersion of the buyers has been a particular barrier in that the firm has had to adapt to numerous markets regarding work methods and documents. To overcome this barrier required focused efforts, among others: Highly mobile managers, and if a network of intermediaries is used in each country, a constant search for skilled employees and a fixed, competent team in charge of the administration.

Sources: LA MAISON DE L'EXPORT (THE HOUSE OF EXPORT) 'Paroles d'exportateurs' ('Exporters' words') (témoignages, expériences de PME) (accounts, experiences of SMEs) (1998)

In the perspective of the value chain - and the increasing competition between manufacturing, distribution and trade - access to new and larger markets as a motive for internationalisation has wider implications. In order to make their distribution and trade activities more cost-effective and to have direct access to market information, some manufacturing SMEs and larger enterprises establish their own distribution channels. This is also a way to control the entire distribution process. Through this process, distribution and trade will become an integrated part of the activities of the manufacturing industries. Examples are found within fashion production/fashion retail as well as production and retail of clothing and electronics.

A co-operative arrangement based on the motive of access to larger markets for one partner and the motive of access to know-how and technology for the other partner may also become an interesting model of internationalisation for more SMEs in the future. Such an arrangement could consist in one partner providing market access and the other partner providing insight into product development. This can be associated with the increasing co-operation between different businesses within the value chain. A Swedish survey<sup>36</sup> describes that closer co-operation between buyers and sub-suppliers in the forest and paper product industry is in progress, as the buyers are increasingly involved in product development. In return, the sub-suppliers get access to the buyer's global distribution network for marketing their own products. In addition, the Swedish survey reveals a strategy of decreasing dependence by small enterprises on larger enterprises, a conscious strategy on the part of the SMEs to lessen their vulnerability and secure long-term profitability.

Access to additional production capacity

Internationalisation is also very often initiated in order to gain access to cheaper sub-suppliers and/or additional production capacity. This activity oriented towards the management of production has its roots in the manufacturing industries where activities have been outsourced internationally due to high production costs or a strategic decision to focus on core skills with the result that other activities have been outsourced.

A special case relating to inward activities can be found in the retail sector. In Europe, some retail companies of everyday commodities have grown to become MNEs. These companies will typically be present in many countries e.g. the France Carrefour-Promodes or the Dutch Royal Ahold. The consequences for the SMEs are two-fold. First, such a MNE has a very strong bargaining position that allows them to dictate the features of the product and the amount delivered, and they are also able to squeeze the profit margin of the sub-supplying SMEs. Secondly, SMEs within everyday commodities might not focus on internationalisation as a main business strategy,

<sup>36</sup> Karlsson, S. et al.: More than a lot of paper! - Innovations and development within Värmlands' Forrest Industry Cluster- Paper Province. Swedish Agency for Innovation Systems, 2001.

but due to the internationalisation of larger companies, the locally oriented SMEs meet increasing and heavy competition, which in recent years has squeezed retailing SMEs out of the market.

#### Access to capital

Finally, access to capital is not cited as one of the most frequent motives for going international, as seen in Figure 3.1. However, for some SMEs, particularly in the biotech sectors, the opportunity of obtaining financing via license agreements or long-term supply agreements with large MNEs is a growing motive<sup>37</sup>.

### **3.3. Hesitations about internationalisation**

When analysing the different types of drivers and motives SMEs may have for internationalisation, it may be useful to look into the reasons why non-internationalised SMEs abstain from internationalisation.

The group of non-internationalised SMEs may be divided into two categories: those who find internal or external barriers too high, and those who would not even consider going international. The different barriers hindering internationalisation as perceived by some SMEs will be discussed more thoroughly in Chapter 4.

When it comes to the group that never considered internationalisation, their hesitations are often not based on barriers as such. Some may consider internationalising irrelevant for their line of business and some believe the domestic demand to be sufficient both now and in the future. Some SMEs (or founders) may simply not have any ambition to grow beyond a certain size, or beyond the domestic market. Different national studies indicate that there is a relatively widespread belief among SMEs that the home market is large enough both now and in the future. In a study from Luxembourg of 959 exporting SMEs in the craft sector, 42 per cent cited 'National demand too high' as their reason not to internationalise.<sup>38</sup> A Belgian study found similar results.<sup>39</sup>

A Swedish study reports that the limited number of small enterprises with export seems to be related to a dislike or fear of external dependence and loss of control.<sup>40</sup> These findings point to a certain tendency among some SMEs to perceive a small company size to be advantageous in some respects and therefore have no wish to engage in international activities.

37 OECD, Global Industrial Restructuring: Implications for Small Firms, OECD Working Paper 2002/4 by Kentaro Sakai, February 2002.

38 Centre de Promotion et de Recherche, Investigation into the export activity and the participation in national and international fairs of companies belonging to the craft sector, Chambre des Métiers du Grand-Duché de Luxembourg, Luxembourg, 1992.

39 Donckels, R. & Aerts, R., KMO's en internationalisering (SMEs and internationalisation), Koning Boudewijnstichting in cooperation with the Small Business Research Institute and CERA, Brussels, 1992.

40 Kamsvåg, C., Företag och finansiering - problem och möjligheter för småföretag (Business and financing - problems and possibilities for small businesses), Stockholm, 2001.





# Chapter 4

## Managing internationalisation

### 4.1. Planning internationalisation

This section gives a brief description of challenges in terms of management and planning of internationalisation in SMEs.

One frequently mentioned problem regarding the internationalisation of SMEs is the lack of an explicit strategy in the initial phases.<sup>41</sup> This is supported by many studies that point to the first exports as being in response to unsolicited, sporadic demands from foreign companies (see Chapter 3).

Another frequently mentioned problem is the lack of know-how with respect to international activities, identifying appropriate partners or assessing market potential. These are problems relating to the management, or more specifically, the Chief Executive Officer (CEO). According to one Swedish study<sup>42</sup>, when it comes to internationalisation, executives can roughly be characterised as focusing on technology, marketing and structure, but less on strategy and planning.

A German study supports this finding of low emphasis on the internal strategic management of the internationalisation process. The German survey from 2001 of 533 enterprises<sup>43</sup> analyses the importance of planning the internationalisation process, as perceived by internationally active SMEs. The SMEs were asked how important they consider various planning activities and which activities they have already carried out in practice. Almost three quarters (73 %) consider the analysis of the foreign market potential as (very) important. This result is in line with the predominance of sales-related motives for international activities. Furthermore, many SMEs also attach high importance to analyses of the competitive (68 %) and legal environment (58 %).

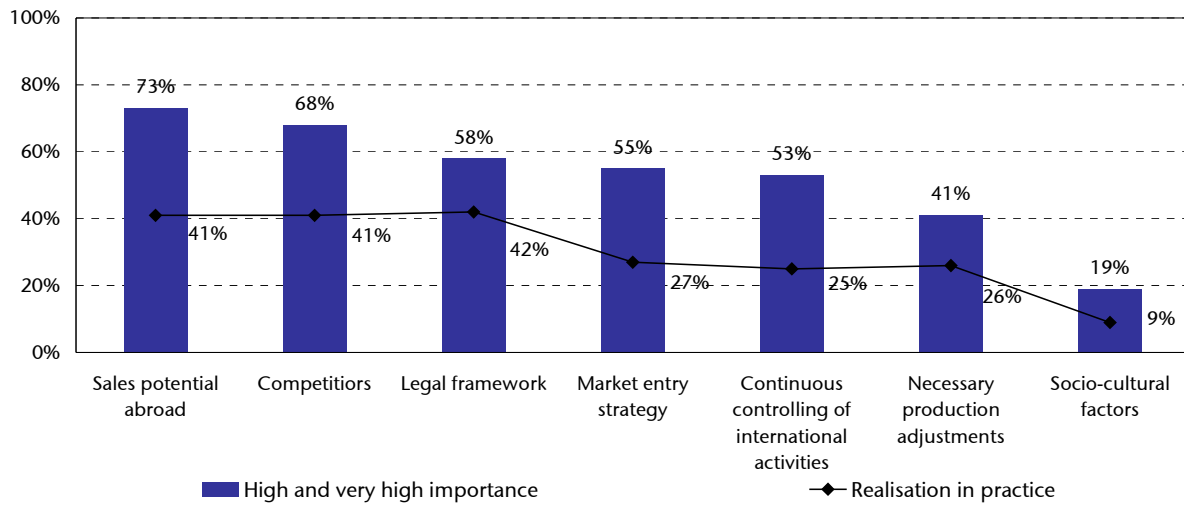
However, the survey identified a considerable gap with respect to the actual realisation of planning activities, as can be seen from Figure 4.1.

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41 Martínez M. C., Determinantes en la internacionalización de las PYMES: casos de estudio en Alicante (Drivers for internationalisation among SMEs: case-studies from Alicante), in *Economía Industrial*, No. 332, Madrid, 2000.

42 Andersson, S., *Internationalisering som entreprenörshandling - En studie av svenska gummivaruföretag. (Internationalising as an entrepreneurial act - A study of Swedish rubber goods business)*, Lindköping, 1996.

43 Bassen, A., Behnam & Gilbert, *Internationalisierung des Mittelstands. Ergebnisse einer empirischen Studie zum Internationalisierungsverhalten deutscher mittelständischer Unternehmen*, in: *Zeitschrift für Betriebswirtschaft*, (Internationalisation of SMEs. Results of an empirical study on patterns of internationalisation of German SMEs), Vol. 71, No. 4/2001, Wiesbaden, 2001. In the period between August and October 1998, postal questionnaires were sent to 6 000 manufacturing and service enterprises with an annual turnover between 12.5 Million EUR and 500 Million EUR. The study is based on answers from 533 enterprises.

**Figure 4.1: Importance of various planning activities with respect to internationalisation, in %**

Source: Bassen, A., Behnam & Gilbert (2001), Internationalisierung des Mittelstands, Ergebnisse einer empirischen Studie zum Internationalisierungsverhalten deutscher mittelständischer Unternehmen, in: Zeitschrift für Betriebswirtschaft, Vol. 71, No. 4/2001, Wiesbaden, 2001, p. 423.

A closer look at those SMEs that attribute (very) high importance to various planning activities, reveals that between one third and half of these SMEs have not yet implemented planning activities, although they consider these activities (very) important. Thus only 41 per cent have carried through an analysis of the foreign market potential, even though 73 per cent considered this analysis (very) important. The gap is equally great between the acknowledged importance of planning the market entry strategy (55 %) and the actual realisation (27 %).

These results suggest that many internationally active SMEs do indeed acknowledge the high importance of planning activities. Nevertheless, there are still considerable deficits with regard to the actual implementation of these activities. This was concluded to be mostly due to SMEs' limited time, management and financial capacities.<sup>44</sup>

The importance of strategy, planning and communication with the employees and other stakeholders was also emphasised in a recent seminar held by the European Foundation for the Improvement of Living and Working Conditions.<sup>45</sup> The business cases presented at the seminar showed that a clear strategy and timely, comprehensive and honest communication is key to a successful internationalisation project. The main goal is to achieve the most widespread acceptance and support for the internationalisation project.

## 4.2. Internal competences and barriers

This section focuses on the importance of internal competences and barriers to internationalisation, especially from the manager's perspective.

Engaging in international activities requires additional competencies compared to strictly domestic activities. The competencies needed typically encompass not only a different working language in relation to cross-border relations, but also knowledge about the foreign market conditions, laws and regulations, cultural differences etc. These competencies can be developed in a learning-by-doing process or by employing experts. However, the amount of international experience of the management or CEO may be of major importance. A number of studies point to the importance of the mindset and experience of managers as regards the internationalisation of

<sup>44</sup> Bassen, A., Behnam & Gilbert, Internationalisierung des Mittelstands. Ergebnisse einer empirischen Studie zum Internationalisierungsverhalten deutscher mittelständischer Unternehmen, in: Zeitschrift für Betriebswirtschaft, (Internationalisation of SMEs. Results of an empirical study on patterns of internationalisation of German SMEs), Wiesbaden, 2001, p. 424.

<sup>45</sup> The European Foundation for the Improvement of Living and Working Conditions: Managing Business Internationalisation, ([www.emcc.eurofound.eu.int](http://www.emcc.eurofound.eu.int)), Seminar held in Brussels, March 2003.

firms. Studies show that personal factors like the personality and individual preferences of the owners of small firms; their commitment and persistence are crucial factors for a firm's growth abroad.<sup>46</sup>

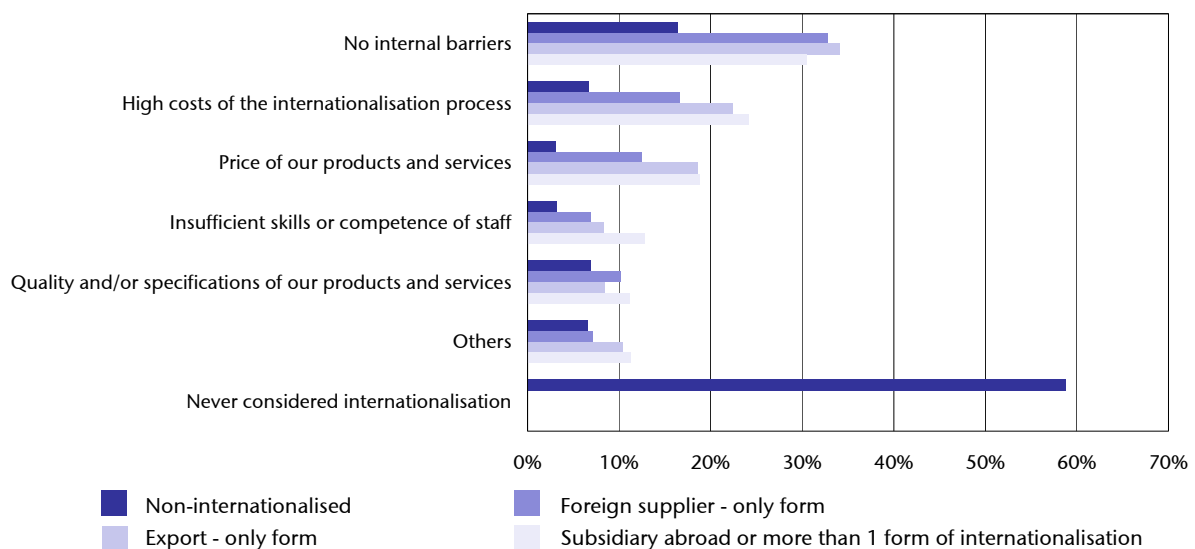
Several studies find that the *international* experience of the founder(s) or manager(s) increases the speed of foreign market entry, this was also a conclusion in a British/German study<sup>47</sup> in 2001 on high-tech start-ups. An Icelandic study<sup>48</sup> indicates that managers with extensive foreign experience are found much more frequently in exporting SMEs, than in non-internationalised SMEs. The findings do not, however, provide evidence that managers with prior international experience drive SMEs into international business more successfully than other managers, or that SMEs with international aspirations tend to employ managers with international experience. The findings are likely to cover both scenarios. In either case, the findings seem to indicate that an international mindset and experience of the managers is likely to promote the international activities of an SME.

For SMEs, the question of attaining sufficient internal resources for cross-border activities is more acute than for larger enterprises, since the costs of hiring people with the appropriate skills are proportionately greater for smaller companies. Large companies have more labour resources to draw from in the first place and they also often have more developed routines and capacities for recruiting, selecting and integrating new employees.

To what extent are these different competencies needed in relation to international activities perceived as barriers by the SMEs?

Figure 4.2 shows the ENSR Enterprise survey results on internal barriers encountered by different groups of SMEs.

**Figure 4.2: Internal barriers to internationalisation**



Source: ENSR Enterprise Survey, 2003.

The most cited barrier, for all three groups of internationalised SMEs is the high costs of the internationalisation process. These costs may include doing market analysis abroad, purchasing legal consulting services, translation of documents, adaptation of products to foreign markets, travel expenses, not to mention a higher business and financial risk. Close to one in four (24 %) of the SMEs with a subsidiary abroad or more than one form of internationalisation find the high costs a barrier.

46 CEDEFOP, Internationalisation and changing skills needs in European small firms, Synthesis Report (CEDEFOP Reference series 23) and National Report of Greece: European Centre for the Development of Vocational Training, Luxembourg, 2002.

47 Bürgel, O., Fier, Licht and Murray, Timing of International Market Entry of the UK and German High-Tech Start-ups, in: Zentrum für Europäische Wirtschaftsforschung (ZEW) (ed.): ZEW Discussion Papers, No. 01-51, Mannheim, 2001.

48 Sigfusson, T., The mindset of managers in geocentric and ethnocentric firms, in 'Rannsóknir í Félagsvísindum IV', a collection of conference papers from the University of Iceland in February 2003, Reykjavík, 2003.

In general, SMEs with only imports perceive fewer internal barriers than SMEs with more outward international activities. For instance the barrier of insufficient skills or competence of staff occurs more often for exporters than for importers and more often for SMEs with subsidiaries than for exporting SMEs. It would thus seem, that the more complex the internationalisation activities that are undertaken, the more internal barriers are generally perceived by the SME.

However, it is worth noting that more than 30 per cent of the internationalised SMEs perceive no internal barriers for the internationalisation process at all. Furthermore, 59 per cent of the non-internationalised SMEs have never considered internationalisation. For these SMEs it seems that internal barriers are not so much a hindrance to internationalisation as the mindset or lack of motivation or experience of the management, as it was indicated earlier with reference to an Icelandic study.<sup>49</sup>

As indicated in the section on the planning of the internationalisation process, in relation to the experience and mindset of the manager(s) or the founder, the lack of organisation and planning of strategic efforts may represent a major barrier to internationalisation. This type of barrier is, however, only acknowledged once the enterprise has considered or embarked on an internationalisation process.

Internal competences of the employees and the managers are thus essential for the internationalisation process. This includes cross-cultural competences, language competences, foreign market knowledge etc. Other resources may be integrated in the management of internationalisation to support the endeavour, and a particularly essential resource is the use of the Internet.

### 4.3. The Internet as a crucial resource

The Internet is a tool for companies in many different ways, and has come to be a success factor for more and more SMEs. Web-based sales, Internet marketing, communications networks play an important role to help SMEs internationalise. The Internet has contributed to new opportunities for internationalisation as shown by several recent studies from different countries (Spigarelli (2003), Dellner et al. (1999) and Karlsson et al. (1998)).<sup>50</sup> Enterprises that can offer trade via the Internet have rapid access to different international markets; they can collaborate in flexible, and decentralised networks with minimum effort.

There is evidence that small firms are gradually becoming more aware of the potential benefits of information technology for their business operations. The ENSR enterprise surveys 1999-2002 show an important continuing increase in the share of SMEs with access to the Internet. There are, however, still size differences among the SMEs: it is estimated that in 2002, 70-75 per cent of European micro enterprises had access to the Internet, but this was true for 85-90 per cent of small enterprises and more than 95 per cent of the medium-sized enterprises.<sup>51</sup> The results from 2002 also show that the share of SMEs with access to the Internet is 69 per cent or more in all European countries.

There is also a continuing growth in the share of European consumers with Internet access which is further facilitating the internationalisation via the Internet for SMEs, allowing them to reach much larger markets and to go international with much less investment.

A business example of successful use of Internet-based marketing is the Farmyard Nurseries case in Textbox 4.1.

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49 Sigfusson, T., The mindset of managers in geocentric and ethnocentric firms, in 'Rannsóknir í Félagsvísindum IV', a collection of conference papers from the University of Iceland in February 2003, Reykjavik, 2003.

50 Spigarelli, F., Processi di internazionalizzazione delle PMI. Un'analisi empirica sul contesto produttivo marchigiano (Internationalisation processes of SMEs. An empirical analysis of the productive context of the Marche region), *Economia & Management* No. 3/2003, SDA Bocconi, Milan, 2003 and Dellner, E. and Lundgren, Globalisation via Internet - An Internet-based business model, Stockholm University, Stockholm, 1999 and Karlsson, J., Lindqvist and Nilsson, The influence of the Internet on the internationalisation of small and large enterprises, *Mitthögskolan* (Mid Sweden University), Sweden, 1998.

51 European Commission, The European Observatory for SMEs - Highlights from the 2002 survey - submitted to the Enterprise Directorate General by KPMG Consulting, EIM Business & Policy Research, and ENSR, Luxembourg, 2002, No. 8.

**Textbox 4.1 Farmyard Nurseries (Wales, the United Kingdom) - Web marketing to get international exposure**

Farmyard Nurseries (FN) has 27 employees and has existed for 4 years. FN grows a number of specialist plants, including Hellebore Orientalis. In order to expand, the business needed to develop its customer base and reach new markets outside of the local catchments area. The business took a 'get-their-hands-dirty' pragmatic approach to eCommerce and focused mainly on the use of an informative web site supported by Email. Use of eCommerce has brought both direct and indirect benefits, but this has only been achieved by putting considerable effort into the marketing of the company's web site.

**Use of eCommerce**

To FN, eCommerce was not about selling from a web site, but, rather, making use of various Internet-based solutions to improve the marketing of the business and communications with customers. At the beginning of the project, they felt that the gardening community was not ready to buy on-line. When considering the potential of eCommerce applications, the conclusion was quickly reached that of all the available technologies, the Internet, especially email and the World Wide Web (WWW), were the ones with the greatest opportunity. They offered the potential to place information regarding FN's specialist plants before a worldwide audience at a relatively low cost. However, as the business now understands, the marketing of a web site is crucial - leaving the pages to sit in splendid isolation does not attract many visitors! The use of eCommerce was seen by the business as one of the factors, which influenced the decision of the National Botanic Garden of Wales to award them the contract to run the new plant centre. eCommerce and the award of the contract resulted in significant changes to the business in 2000, during which period the company's turnover doubled and the number of employees increased by 13. A well-planned mix of Web and traditional marketing has contributed to this result.

**The main benefits for the enterprise**

Better access to the market, increased efficiency in logistics and distributive system, more time for analysing the market and for marketing, direct marketing and sales for the purpose of eliminating distribution costs.

Source: <http://www.opportunitywales.co.uk/farmyard.pdf>.

Companies within the ICT industry itself also seem to achieve a higher degree of internationalisation than the average. For instance, an Irish study found<sup>52</sup> that Irish software companies in general exported 69 % of their output in 1997.

The growing number of cross-border alliances involving SMEs in computer-related services also illustrates the growing importance of the Internet in relation to internationalisation. 260 international alliances in computer-related services were made in the last decade involving SMEs.<sup>53</sup> The alliances may be established to create a Web site or online shop or to provide technical support for business-to-business (B2B) and business-to-consumer (B2C) electronic commerce.

The number of cross-border alliances in computer-related services involving SMEs has increased rapidly in recent years. They accounted for two-thirds of the overall growth in international alliances involving SMEs in business services during the second half of the 1990s. The ICT/Internet SMEs involved are primarily medium-sized.

## 4.4. External barriers for internationalisation

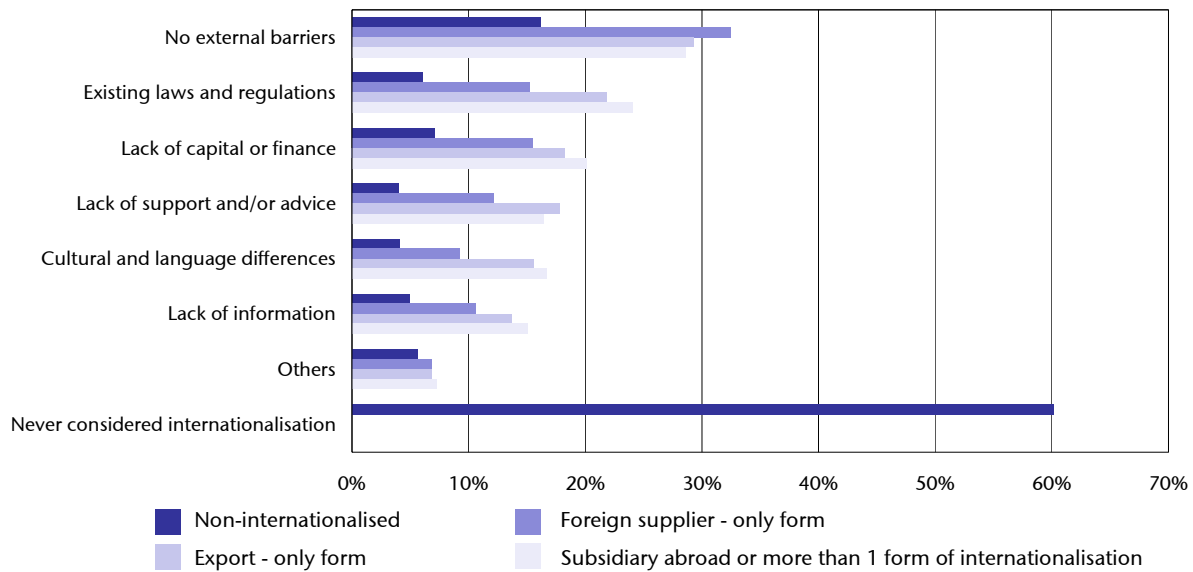
### - integration of markets

This section deals with the external barriers encountered by the SMEs in their internationalisation process.

Figure 4.3 shows the ENSR Enterprise Survey results with respect to external barriers to internationalisation.

52 O'Malley, E. & O'Gorman, C., *Competitive Advantage in the Irish Indigenous Software Industry and the Role of Inward Foreign Direct Investment*, European Planning Studies, Vol. 9, No. 3, Basingstoke, 2001.

53 OECD, *Global Industrial Restructuring: Implications for Small Firms*, OECD Working Paper 2002/4 by Kentaro Sakai, February 2002.

**Figure 4.3 External barriers to internationalisation**

Source: ENSR Enterprise Survey, 2003.

Perhaps the most interesting feature is that almost a third of the internationalised enterprises perceive no external barriers but SMEs with foreign supplier are most likely to see no barriers. Moreover, when considering the other categories or barriers it seems that the more complex the international activities undertaken by the SME are, the more often they perceive barriers. This indicates, that barriers are usually discovered, as the different types of international activities are developed.

Lack of support/advice or lack of information are not very common barriers, as can be seen in Figure 4.3. This may reflect the relatively widespread existence of policy measures directed towards informing and supporting internationalising enterprises. (See Chapter 6). Between 12 and 18 per cent of the internationalised SMEs perceive a lack of support/advice, and 10 to 15 per cent perceive lack of information as an external barrier.

The most cited external barrier, however, is the existing laws and regulations, typically of the target countries.

#### Existing laws and regulations as a barrier

Laws and regulations are perceived more frequently as a barrier for SMEs with foreign subsidiaries or several forms of internationalisation (24 %). However, SMEs with only foreign suppliers also meet this barrier, as well as the other barriers. This indicates that importing SMEs need supporting measures to overcome external barriers to almost the same extent as exporting SMEs. However, it can not, on the basis of the ENSR Enterprise Survey be concluded to which extent the barrier is related to the differences in national regulations (lack of harmonisation) or general lack of knowledge on legal regimes and to which extent it is specific difficulties created by existing national regulations that constitute barriers to SMEs internationalisation.

A recent survey of the legal and administrative barriers for mergers and acquisitions in the Nordic countries emphasises the importance of these barriers.<sup>54</sup> From 1997-2001, more than 500 cross-border mergers or acquisitions took place, involving companies from more than one Nordic country.

The Nordic survey shows that tax regulations and company laws still represent significant barriers for the development of the Nordic businesses. Thus, three in four companies agree that there is a great need for a harmonisation of the laws and regulations in the Nordic countries. The extra administrative costs incurred by a cross-border business deal (among Nordic countries) as opposed to a purely domestic business deal in several cases amounted to 10 per cent of the total administrative costs. The study also concludes that the extra administrative costs are proportionately greater for the smaller companies.

<sup>54</sup> Oxford Research, *Over grænsen efter konkurrenceevne* (Crossing the border to gain competitiveness), for The Nordic Industrial Fund and the Nordic Council of Ministers, Copenhagen, 2002.

Laws and regulations may represent a particularly acute barrier in certain sectors, such as the pharmaceutical sector. The case of EKO-BIO in Textbox 4.2 is an example of an SME having to comply with a very high level of legislative barriers.

**Textbox 4.2 EKO-BIO (the Netherlands) - Tackling external barriers of legislation**

EKO-BIO is a pharmaceutical production company, specialised in food supplements and natural-based medicines. The company was founded in 1993 and has 40 employees.

EKO-BIO has a mixture of direct and indirect exports. For instance the German market is supplied by direct exports, but for the Spanish market, EKO-BIO uses one of the top local distributors of medicines.

The motivation is and was increasing competitiveness. The Dutch market is too small for enterprises like EKO-BIO that conduct their own R&D. To keep the unit production cost at an acceptable level a company must produce more than the home market can absorb. At the moment, the enterprise exports to Germany, Spain, France and South Korea. The enterprise has ambitions to start exports to Scandinavia, because the Scandinavian people are more familiar with using natural-based medicines and food supplements than other Europeans.

The enterprise is, just like all pharmaceutical enterprises, subjected to severe legislation. The ambitions of starting exports to Scandinavian countries have raised the legislative barrier further, as each country has different legislation. In order to tackle this barrier, EKO-BIO subjected itself to the most severe legislation in Europe regarding pharmaceutical products i.e. the Belgium law. Although this represents high demands on the production from the outset, it may save the company resources later on in the internationalisation process when for instance it will start exports to Scandinavia. The burden of adaptation of the production will be less, since the company's production has already been adjusted to the most severe legislation in Europe, i.e. the Belgium legislation.

Sources: ABN-AMRO Bank and MKB-Nederland (2002), Grenzen verleggen met export, tien MKB ondernemers over hun (eerste) exportstappen, Koninklijke-MKB Nederland, Delft, pp. 32-33 (Moving frontiers through export, ten SME entrepreneurs on their (first) export steps.) EKO-BIO-b.v and Managing Director.

### Shortages of capital

In general, the shortage of capital is not seen as a major barrier by European SMEs. When asked in the ENSR survey about external barriers to internationalisation, only a little more than one in ten companies mentioned 'Lack of capital or finance'.

On the other hand, even though only 11 per cent of the companies consider lack of capital a barrier, it is still the second most cited barrier by SMEs in the ENSR Enterprise Survey, as illustrated in Figure 4.3.

Moreover, several national studies indicate that obtaining payments and financing is a major problem for many SMEs.<sup>55</sup> In a Belgian survey,<sup>56</sup> 31 per cent of the SMEs indicated risk of payment/financing as a barrier to internationalisation.

The view that lack of capital is a barrier differs among companies. The ENSR survey shows that there is a difference between the perception of capital shortage according to whether the SME is already internationalised through exports or subsidiaries abroad or not.

As can be seen from Figure 4.3, the more the SMEs engage in outgoing international activities, the more they tend to experience a lack of capital.

The companies that are already internationalised, even merely in the form of a foreign supplier, are more inclined to consider capital shortages as a barrier than the SMEs with no international activities. Again this suggests that capital is not viewed as a barrier until the company starts to internationalise. This finding has emerged in national studies, e.g. in Luxembourg.<sup>57</sup>

<sup>55</sup> Prince, Y.M. and Versfeld, Exportkansen voor MKB: Key-Regio's, (Chances for SME exports, Key-Regions), Stichting Exportraad midden- en kleinbedrijf, Voorburg, 1996.

<sup>56</sup> Donckels, R. & Aerts, KMO's en internationalisering (SMEs and internationalisation), Koning Boudewijnstichting in cooperation with the Small Business Research Institute and CERA, Brussels, 1992.

<sup>57</sup> Centre de Promotion et de Recherche, Investigation on the export activity and the participation in national and international fairs of companies belonging to the craft sector, Chambre des Métiers du Grand-Duché de Luxembourg, Luxembourg, 1992.



That capital seems to be a greater barrier for internationalised companies may also explain some of the variations across business sectors. The ENSR Enterprise Survey shows that companies in the manufacturing, transportation/communication and wholesale sectors more often consider shortage of capital as a barrier, whereas companies in the retailing and personal service sectors are slightly less likely to do so. This may relate to the fact that the manufacturing, transportation/communication and wholesale sectors are the most internationalised.

The ENSR Enterprise Survey also finds that companies with between 10 and 49 employees more often (15 %) perceive capital shortage as a barrier than the rest of the SMEs.

However, the most distinct difference, as shown in the survey, is the one between individual countries. The perception of lack of capital as a barrier is lowest in Norway, the Netherlands and Greece starting at only 4 %, and highest in Austria, Luxembourg, Liechtenstein and Iceland with Iceland topping the list with 19 %. It is to be noted that for some of the most internationalised countries a high percentage of SMEs view capital shortage as a barrier to internationalisation. Iceland is the country with the highest percentage of SMEs with foreign subsidiaries, while Luxembourg and Liechtenstein have the highest number of exporting SMEs and Austria the fourth highest percentage of exporting SMEs. Studies from countries such as Austria and Luxembourg confirm the pattern found in the ENSR Enterprise Survey.<sup>58</sup>

### Trade barriers

Some external barriers for expanding international activities relate to trade barriers. These include trade policy; EU-standards, national trade protection (national policy or 'voluntary trade marks'); technical standards, national regulation on safety, consumer protection etc.

Due to the formation of the single customs union, many of the formal tariff trade barriers have been mitigated. However, it may be the case that a number of non-tariff barriers still persist, product specification, cultural differences, national preferences etc.

A Danish survey from 2003<sup>59</sup> of 400 enterprises enquired into the amount of trade barriers encountered by internationalising enterprises. The study found that approximately half of all Danish export businesses (52 %) still encounter trade barriers to their export markets today. Five years ago, this number was virtually the same (55 %). The majority of Danish export businesses (63 %) have experienced the same degree of trade barriers during the last five years. Thus, ten years after the introduction of the Internal Market, companies still encounter a substantial number of technical trade barriers within the EU.

The same results apply to enterprises with subsidiaries abroad: the report indicates that 69 % of all exporting businesses who have subsidiaries abroad have encountered barriers in connection with their setting up of a subsidiary abroad.

On the whole the level of trade barriers seems to have remained roughly the same, but this covers two different trends for two specific types of trade barriers: the most frequent trade barrier met by Danish businesses was special product requirements i.e. requirements to meet specific national or local standards, or requirements for re-testing or certification of a product. This barrier has actually decreased in importance over the last five years, as national product requirements have been reduced on the EU market.

However, the second most important type of trade barriers faced by Danish businesses, was specific marketing requirements, and this type of trade barrier has become increasingly frequent over the past five years. Specific marketing requirements regarding labels/declaration of contents as well as specific language requirements with regard to the marketing of the product have been brought into focus.

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58 Kisslinger, M., Erfolgsfaktoren von Kooperationen als mögliche Internationalisierungsstrategie von KMU (Success Factors of Co-operations: A potential Internationalisation Strategy of SMEs). Linz: Thesis at the Johannes Kepler University Linz, 2002. and Centre de Promotion et de Recherche, Investigation on the export activity and the participation in national and international fairs of companies belonging to the craft sector, Chambre des Métiers du Grand-Duché de Luxembourg, Luxembourg, 1992.

59 The Danish National Agency for Enterprise and Housing, Handelshindringer for danske eksportvirksomheder (Trade barriers for Danish exporting companies), Copenhagen, 2003.

# Chapter 5

## Impact on competitiveness

### 5.1. Introduction

This section will investigate how internationalisation affects SME competitiveness and show how internationalised SMEs perform compared to other SMEs.

International activities may have some quantifiable effects on sales (turnover) but they may also affect the firm's competitiveness in general or in specific areas in a way that is not easy to measure. The enterprise may for instance improve its cost-efficiency by outsourcing abroad or it may develop its know-how and technology competencies via collaboration with clients or suppliers in other countries.

However, engaging in international activities may also have more indirect positive impacts on the competitiveness of the SME. Initiating trade or collaboration with partners in other countries may offer new challenges and opportunities to the employees or improve the SMEs' scope of recruitment and their ability to maintain highly skilled employees that often focus on career and personal development.

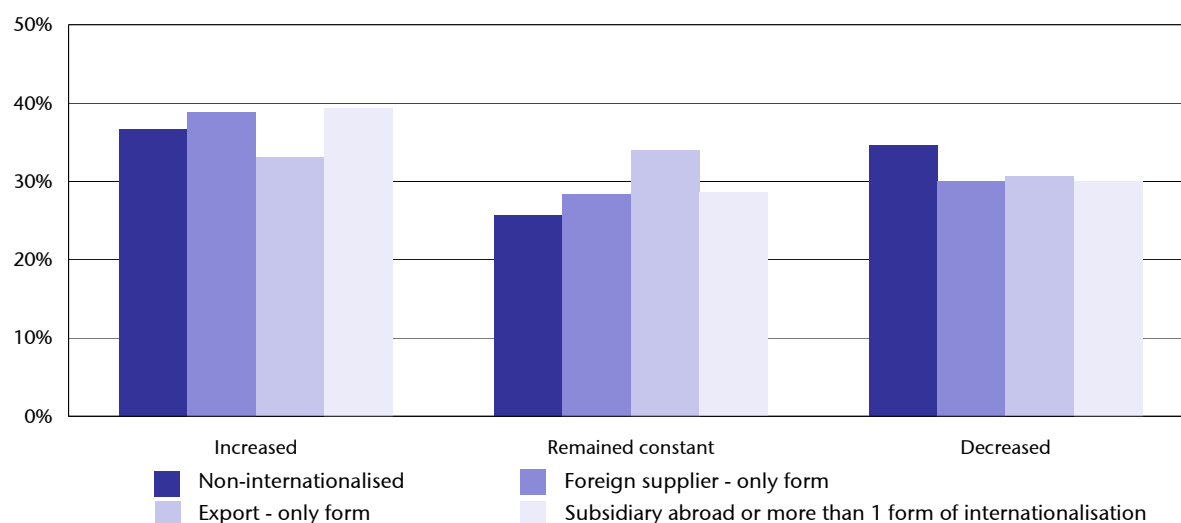
In Section 5.2 the correlation between internationalisation and development of turnover is investigated on the basis of the ENSR Enterprise Survey results.

Section 5.3 presents results from various national studies and from the ENSR Enterprise Survey on the effect of internationalisation on competitiveness. It is important to note that this question in the survey reflects a general perception by the SME respondents, and that their responses may cover both direct and indirect improvements of competitiveness as discussed above.

The two final sections analyse the competitiveness effect in relation to different size classes as well as the effect of co-operation on competitiveness.

### 5.2. Impact on competitiveness via increases in turnover

One way to assess the economic effect of internationalisation is to compare the turnover of internationalised SMEs versus non-internationalised SMEs. In Figure 5.1, the change in turnover 2001-2002 is illustrated for the four groups of SMEs: non-internationalised SMEs, SMEs with foreign supplier only, SMEs with export only and SMEs with more complex international activities.

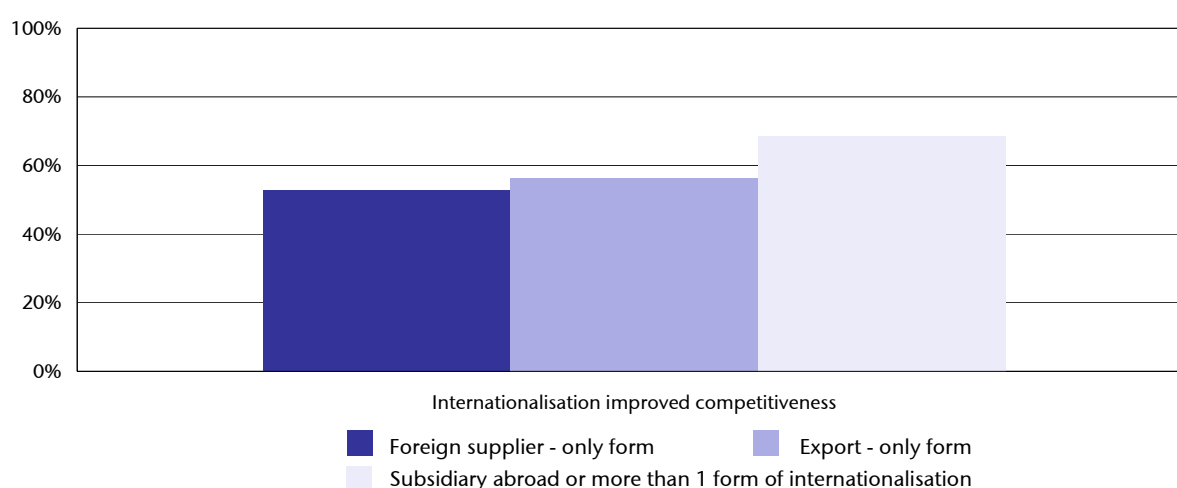
**Figure 5.1: Turnover 2002 compared to 2001**

Source: ENSR Enterprise Survey, 2003.

The group of non-internationalised SMEs has the highest percentage of enterprises that experienced a decrease in turnover from 2001 to 2002. Similarly, both SMEs with a foreign supplier and those with more complex international activities have experienced increases in turnover more frequently than the non-internationalised. It would thus seem, that international activities more often lead to constant or increased turnover instead of decreased turnover, than having only domestic activities.

### 5.3. Competitiveness as a result of internationalisation

Figure 5.2 presents the share of SMEs that register an improvement in their competitiveness as a result of their internationalising. The figure clearly shows, that a majority of SMEs in all three groups perceive a positive impact of internationalisation on competitiveness, but more complex forms of internationalisation are perceived to have a greater effect on the competitiveness.

**Figure 5.2: Internationalisation has improved competitive strength**

Source: ENSR Enterprise Survey, 2003.

Of the SMEs with subsidiaries abroad or more than one form of internationalisation, 69 per cent find that their competitiveness has improved. In comparison, this is the case for 53 per cent of SMEs with foreign supplier only and for 56 per cent with export only.

Some other studies have also examined the effect of internationalisation on the competitiveness of SMEs.

A recent Italian study<sup>60</sup> gives a possible reason for the better performance, on average, of those firms with more complex forms of internationalisation. On the basis of data from 220 Italian SMEs, the performance seems related to the ability of the firm to gain access to the North American market. Similarly, the ENSR Enterprise Survey, indicates that SMEs that have complex international activities in the US perform better than those SMEs with only a foreign supplier or exports to the US. Both the ENSR Enterprise Survey and the Italian study thus indicate, that the challenges of entering the American market successfully push SMEs to develop competencies that eventually lead to better overall performance.

A German survey of 633 enterprises<sup>61</sup> concludes, that the competitiveness of enterprises increases considerably with the degree to which they have business contacts and sales offices/production sites in other countries. Moreover, enterprises with a high export share have a much higher valuation of their competitive strength than enterprises with lower export activities. The German survey thus supports the findings of the ENSR Enterprise Survey 2003, that increased internationalisation typically will strengthen the competitive position of the enterprise.

A Spanish study using data on SMEs financial performance confirms that internationalised SMEs perform better than non-internationalised SMEs.<sup>62</sup>

A Finnish study of 200 industrial SMEs indicates that internationalisation seems to have positive effects in particular on manufacturing, marketing and acquisitions of companies.<sup>63</sup>

The Greek manufacturer of men's underwear, Apple Boxer S.A. is an interesting case in showing that internationalisation is risky, but that it may nonetheless help improve competitiveness in the domestic market. The case is presented in Textbox 5.1.

#### **Textbox 5.1 APPLE BOXER S.A. - Internationalising in search of competitiveness**

In Greece, APPLE BOXER S.A. is producing and exporting ready-made clothes, primarily men's underwear (95 %). The Greek company has existed for 16 years and has 76 employees.

APPLE BOXER started exporting ten years ago. Until two years ago, the company exported to the Netherlands, Germany, Belgium, the Czech Republic, and Cyprus. For the last two years, however, due to the intensified competition in the European Union member countries and the Czech Republic, the company has restricted its exporting activity to Cyprus. The export rate to Cyprus has been increasing.

The high relative prices of APPLE BOXER's products compared to corresponding goods sold in Germany, the Netherlands, the Czech Republic and Belgium constituted a serious barrier for exports to these countries. The low competitiveness was due to high production costs.

It was thus an important strategic decision in the search for competitiveness on the European markets for underwear, to outsource/subcontract some of the production to China. However, considerable delays in delivery of goods from China, due to problems with long distances and time-consuming bureaucracy, forced the firm to keep its core production line in the domestic market.

Nevertheless, APPLE BOXER's contact with foreign markets has had a positive impact on its performance in general. It has strengthened its position in domestic markets and facilitated its bargaining position as regards contracts with domestic sub-suppliers. The low-cost outsourced production to China (65 per cent lower than the corresponding production cost in the domestic market) has facilitated its leading competitive position in the Greek market.

The Company was 'pushed' to re-organize its distribution channels and logistics in a more effective way, thus reducing storing cost significantly. The Company has already developed its own distributive selling system in Cyprus based on exclusive agents.

Source: Exports registered database.

60 Majocchi, A. & Zucchella, Internationalization and performance, *International Small Business Journal*, London, Vol. 21, issue 3, August 2003.

61 Werner, D., Wettbewerbsfähigkeit und Internationalisierungsstrategien - Befunde einer Unternehmensbefragung (Competitiveness and internationalisation strategies - results of a company survey), in: *IW-Trends*, No. 4/2002.

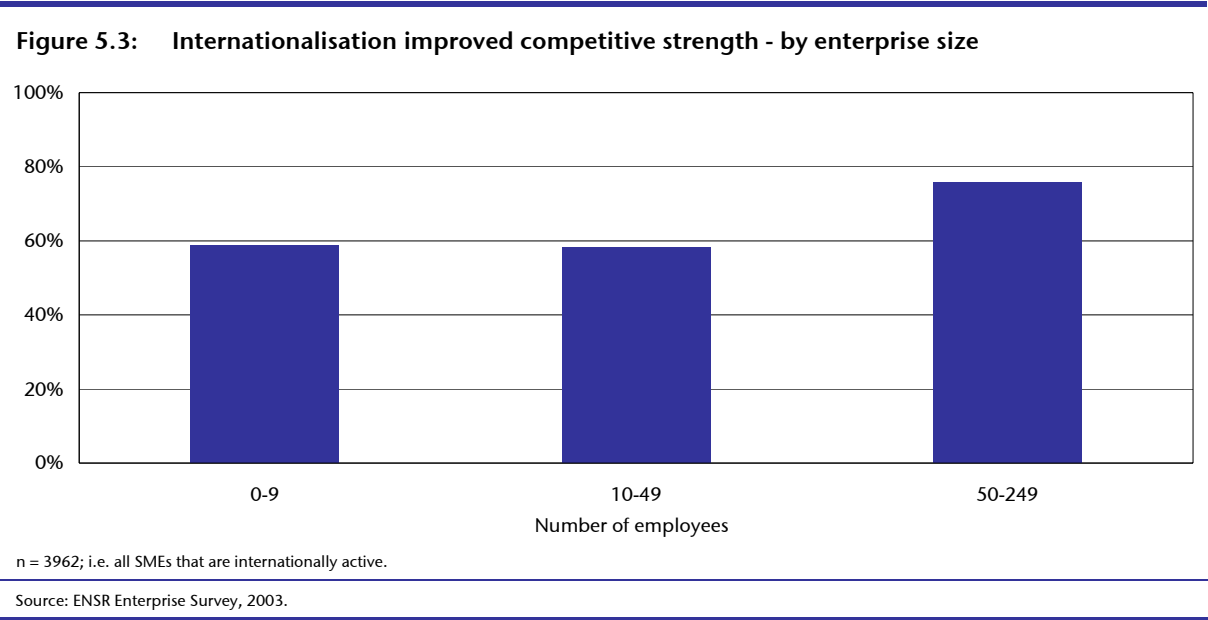
62 García Erquiaga, E., Las pymes y su grado de internacionalización. Cómo incide la internacionalización en el comportamiento estratégico de las empresas gallegas (SMEs and their degree of internationalisation. How internationalisation influences strategic behaviour of Galician enterprises), *Acade National Annual Congress*, Las Palmas de Gran Canaria, 1998.

63 Larimo, J. & Sutinen, K., Vaasan läänin yritysten kansainvälistyminen. 1990-luvun kehitys ja tulevaisuuden näkymät, (Internationalisation of Industrial Enterprises in the Province of Vaasa. Development in the 1990 and Future Prospects). *Proceedings of the University of Vaasa*, Reports 17, Vaasa, 1996.

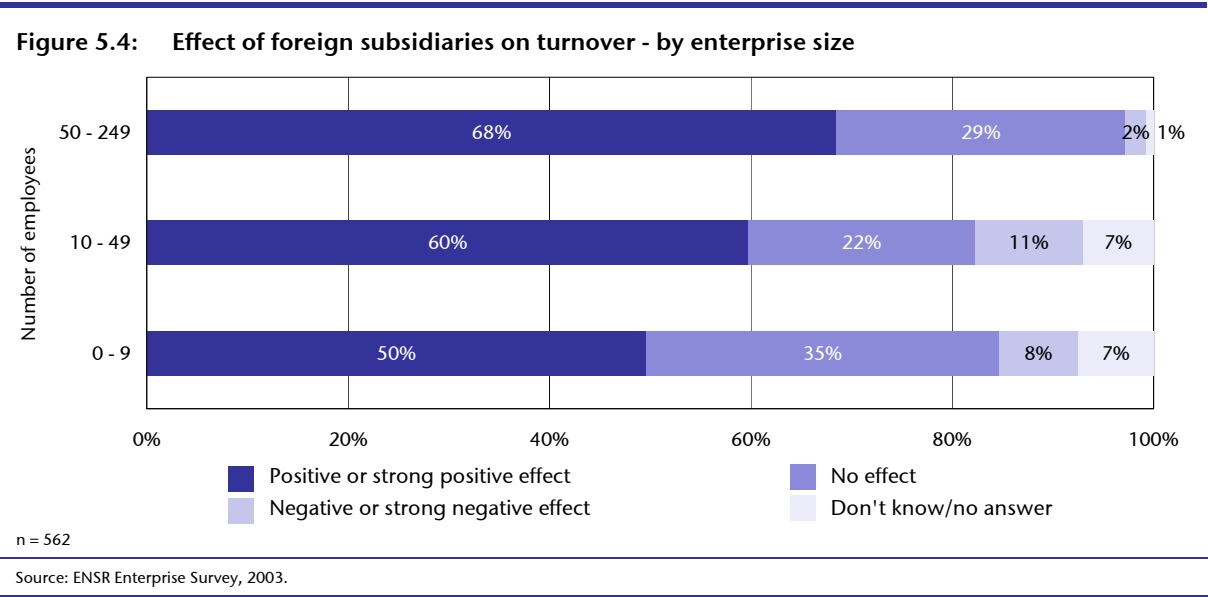
### 5.4. Competitiveness and size classes

Figure 5.3 presents the effect of internationalisation on competitiveness for different size classes, as perceived by enterprises. A closer look reveals that internationalisation is perceived to have significantly greater effect on the competitiveness of medium-sized enterprises than either micro or small enterprises, as shown in Figure 5.3.

This probably reflects relatively higher unit costs of internationalisation for smaller enterprises compared to larger enterprises at least at early stages because of economies of scale.



The data also show that among SMEs with subsidiaries abroad, medium-sized enterprises have registered a greater impact on turnover than micro and small enterprises. This is presented in Figure 5.4.



Among micro enterprises with subsidiaries abroad 50 per cent registered a positive (or strongly positive) effect on their turnover. For medium-sized enterprises, however, the figure is 68 per cent. Roughly between a quarter and a third of the SMEs have registered no effect. Very few have registered a negative effect.

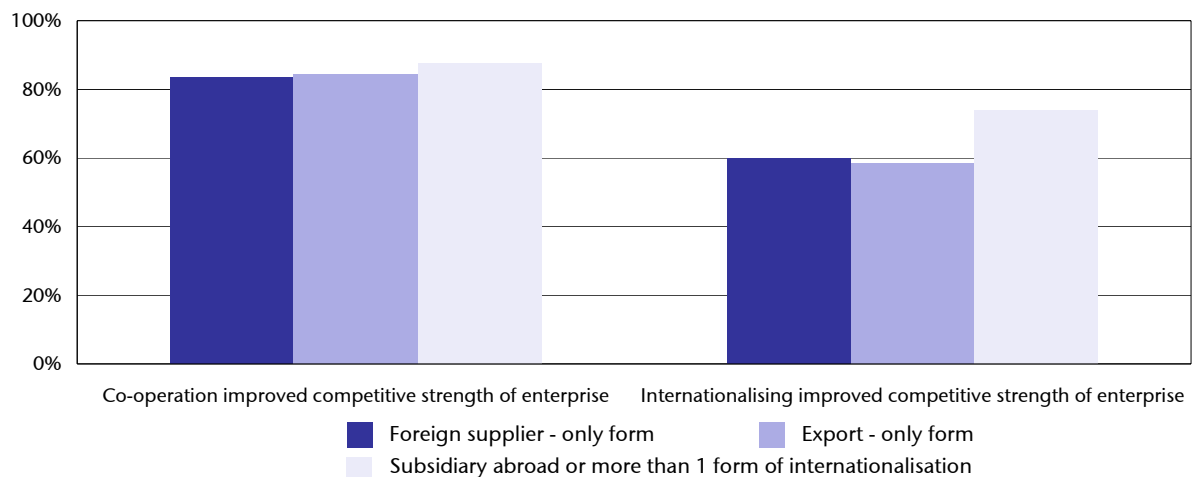
This may lead to the conclusion that the larger the enterprise the more positive effects are perceived from internationalisation. Economies of scale may be one of the reasons for this, but other factors may also be involved.

Large (or medium-sized) enterprises may have access to resources or structures that positively affect their international performances. For instance large enterprises may implement management systems more effectively and they may also deploy more and better-qualified resources.

## 5.5. Competitiveness and collaboration

The findings so far suggest that internationalisation, though risky, has a positive effect on competitiveness. However, international collaboration seems to have a greater impact than international sales on SMEs' competitiveness. Figure 5.5 shows the share of SMEs that have experienced improved competitiveness as a result of either co-operation or of international activities.

**Figure 5.5: Internationalisation or co-operation has improved competitive strength**



Note: For both questions respondents included have both co-operation (formal or in-formal) and at least one form of internationalisation.

Source: ENSR Enterprise Survey, 2003.

Regardless of the form of internationalisation that is chosen, Figure 5.5 shows that the co-operation activities are perceived by the entrepreneurs to have had greater impact than the internationalisation. Figure 5.5 highlights that internationalisation has to be viewed in a very broad perspective, and may be evidence that internationalisation in the form of co-operative relations with foreign companies is an effective way of improving competitiveness, also on the domestic market.

The case presented in Textbox 5.2 is an example of a Dutch enterprise that has improved its competitiveness through international outsourcing and collaboration. The Dutch company Spit Elektromechanica went to Russia to get access to cheaper and more qualified labour to handle software development. The case also underlines that outsourcing is no longer merely a case of finding cheap sub-suppliers, but that all kinds of labour-intensive jobs can be outsourced - or handled in close collaboration with other enterprises.

**Textbox 5.2 Spit Elektromechanica - In search of highly skilled labour at low costs**

Founded in 1994 in the Netherlands, SPIT was originally focused on electromechanical maintenance. Later the company's core activity changed into industrial IT development. SPIT now has 66 employees.

SPIT outsourced part of the repairs of electro engines to Russia, Saint Petersburg. This outsourcing to Saint Petersburg was motivated by cheaper labour. SPIT discovered that in the surrounding region of Saint Petersburg was a large marine base, with large maintenance organisations and repair works that could deliver quality repairs of special motors at a low price.

In September 2003 SPIT planned to open an industrial IT development division (R&D) in the neighbourhood of Saint Petersburg. They use the highly skilled local labour force to develop software. This is possible because Saint Petersburg is a knowledge centre of the IT sector. The region has a high share of people with IT knowledge of a quality, not available in the Netherlands. Moreover, this workforce speaks English and they are relatively cheap compared to highly educated people in the Netherlands. A main problem in Saint Petersburg has been getting accustomed to the local way of negotiation, which requires the use of a local mediator. On the other hand, the burden of economic, ecological and environmental law and regulations is not so heavy in Russia as in the Netherlands.

Sources: Spit Elektromechanica, Managing Director.

# Chapter 6

## Policy measures

### 6.1. Introduction

The preceding chapters have presented the motives for SMEs' internationalisation, the barriers SMEs encounter, the management of the process once the decision to internationalise has been taken, and its effects on competitiveness and competences.

The problems and barriers that SMEs are faced with regarding internationalisation can be addressed by SME policy measures. This chapter will discuss the general scope of these policy measures in the EU Member States and the extent to which these policy measures meet the needs of SMEs.

The main barriers to internationalisation experienced by the SMEs are summarised and followed by an overview of the policy measures that support the internationalisation process also by adopting a holistic perspective. The chapter finally gives examples of policy measures implemented by a few EU Member States.

### 6.2. Main barriers and problems for internationalisation of SMEs

For the sake of clarity in this report, SMEs are grouped into internationalised and non-internationalised.

According to ENSR Survey results, almost 60 per cent of non-internationalised SMEs have never considered internationalisation as a business opportunity. More than 15 per cent of the non-internationalised SMEs have experienced no internal barriers and a similar share of SMEs find no external barriers. Generally, the remaining part of the non-internationalised SMEs (around 25 per cent) experiences the same barriers and problems with regard to internationalisation as the internationalised SMEs. However, many SMEs possibly do not recognise that the internationalisation process affects them even though they operate mainly on the domestic market, since internationalisation is often regarded as similar to exporting. Many SMEs may underestimate international competition even at the domestic level and/or the possibilities of strengthening their competitiveness through international sub-suppliers or accessing knowledge and know-how through international collaboration.

The barriers and the challenges experienced by the internationalised SMEs can be summarised as follows:

- High cost of the internationalisation process (as internal barrier) or lack of capital or finance (as external barrier);
- Lack of explicit strategy in the initial phase and lack of ability to implement strategies (insufficient planning or skills);
- Lack of know-how regarding international issues/managers lack international experience.

In essence, limited time, management and financial capacity seem to represent the main problems and barriers to SMEs' internationalisation.

SMEs also stress that existing laws and regulations constitute a significant barrier, as it has been described in section 4.4, although the ENSR Enterprise Survey results do not allow to conclude to which extent the responses refer to different legal regimes in target countries or the barriers created by existing domestic regulations. Some policy measures that have been reported in the EU Member States address such barriers by providing specific information or counselling on foreign laws and regulations. However, the findings of the research for this report



do not allow to advise which kind of counselling to SMEs is particularly needed, whether it is general information on foreign regulations or general information on the national regulation supporting/governing business internationalisation or other.

### 6.3. Overview of policy measures in the EU Member States

An overview of different types of SME policy measures illustrates how policies encourage SMEs to internationalise. The following section gives examples of policy measures in some EU countries and indicates potential areas of support that seem relatively overlooked by national authorities.

National policy measures can be categorised into five types of support ranging from mainly basic information or export promotion to company-specific measures such as individual consulting and competence development. Most countries have several of the types of support mentioned below.

- Information:
  - Standard information services (available in almost all countries);
  - Internet platform (available only in some countries).
- Promotion:
  - Typically support for participation in foreign trade fairs (almost all countries).
- Financial support:
  - E.g. export credit, export/risk insurance or guarantees (almost all countries);
  - FDI credit, internationalisation support grants (available only in some countries);
  - Tax relief (available only in a few countries).
- Inward investment support (FDI information or financial support).
- Counselling: (individual counselling on export development or the establishment of subsidiaries abroad, competence development, partner introduction/identification, legal advice), (available only in some countries).

The information services may be in the form of publications or conferences, aimed at a larger audience of SMEs (or enterprises in general). They may be supported by an Internet platform, a Web site comprising typically one-way information on target countries, aid measures available, national export promotion activities abroad, legal aspects of different countries, case examples of internationalised companies etc.

Promotional activities are typically in the form of publicly supported and co-ordinated participation in foreign trade fairs.

Financial support is given in different forms, ranging from export credit and guarantees (guarantees and credits issued by public organisations) and in some cases credits related to the establishment of subsidiaries abroad. Some countries also have grants in this field.

Another kind of more indirect internationalisation support is the assistance given to foreign companies planning to invest in the country. This is less frequent, especially in the form of financial aid.

Finally, counselling support exists in different forms but with an individual approach to the information and support given. This support may comprise educational activities and competence development of employees engaged in the international activities. An important form of counselling is assistance with the identification of appropriate partners for business abroad.

Almost all countries have the basic policy measures to assist SMEs in their internationalisation process. However, they are organised in different ways. More than half of the 19 countries have institutions and policies especially targeting SMEs. In the remaining countries, policy measures do not distinguish between companies of different size. On the other hand, some countries have sector-specific policies that favour certain industries. This is especially the case in high tech areas.

Another way to look at the policy measures is to distinguish between the different organisational structures. The structures in the different countries vary considerably. Some countries like Ireland have one central umbrella organisation that takes care of all areas, while other countries have many different specialised institutions, even providing competition in the same services.

## 6.4. Measures addressing the framework condition for internationalisation

Except for Liechtenstein - that has no policy measures at all - all countries have basic policy measures such as general information about exports and foreign markets and help with promotion e.g. participation in foreign trade fairs. These tasks are carried out either by agencies abroad such as embassies and chambers of commerce or by different local agencies. About a third of the countries also have agencies that try to attract foreign direct investment primarily by offering relevant information.

The majority of the 19 countries provide different kinds of export credits, export insurances and export guarantees of which the KfW-SME Programme-Abroad, Germany, presented in Textbox 6.1 is an example. However, the German programme has a very broad approach to the finance of international activities, not limited to export. About half the countries offer this kind of support in relation to foreign direct investment, too.

### Textbox 6.1 KfW-Mittelstandsprogramm-Ausland (KfW-SME Programme-Abroad, Germany)

**The responsible organisation** for this scheme is The Kreditanstalt für Wiederaufbau (KfW) (Reconstruction and Loan Corporation), which is the largest public support bank at national level.

**Overall aim:** KfW's support programme aims to lower market entry barriers in relation to financing problems by offering long-term credits at favourable conditions that can be used for a wide spectrum of international activities.

**Services:** In brief, the programme finances a limited range of total investment expenses:

- All investments that require long-term financing,
- The set-up and purchase of enterprises or equity participations in existing enterprises,
- R&D with regard to new products and/or processes (incl. personnel, material and overhead costs),
- Start-ups founding, launching and growth of business operations (e.g. costs for administrative procedures and permissions, marketing costs, participation in fairs and exhibitions, training costs etc.),
- Preparatory studies and feasibility studies with regard to a specific investment project,
- Purchase of premises that are essential for the investment project.

**Size of the programme:** In the period 1992-1999, in total 1,333 credits were approved involving a credit volume of 1.43 Billion EUR. SMEs have used these credits to finance a total investment volume of 3.89 Billion EUR. SMEs receive 80 % of all credits and have a 64 % share in the total credit volume.

**Experiences:** Almost 40 % of the supported enterprises indicate that their investment project would create additional jobs. The employment effect of the supported foreign investments is much stronger than the domestic ones. On average, every international investment created 19 additional jobs.

Sources: Cp. Kreditanstalt für Wiederaufbau (2001), Kreditanstalt für Wiederaufbau (KfW) (2000), Mann (1999), and the Federal Ministry of Economics and Labour's Internet database of support programmes.

The main part of the framework related measures are of a more passive nature, as they do not provide targeted or interactive coaching for the SMEs. A range of other policy measures addresses more company-specific issues to help the firm improve strategies or competences necessary for internationalisation.

## 6.5. Measures addressing company-specific issues

Most countries provide some individual counselling on export matters and some of them even offer competence development within the individual firm. In these programmes, the companies are taught new competences relevant either to exporting or to the establishment of subsidiaries abroad. Advice may include a marketing plan, the identification of foreign business partners or customers. Several countries also offer financial support to project investigations relating to market potential, by covering part of the expenses.

Recent studies indicate that a more customised support to SMEs' internationalisation is in fact required.<sup>64</sup> The studies indicate that a low awareness of export support programmes by SMEs may be caused in part by a traditional 'stages' approach: when policy measures are targeted at supporting sales drives abroad, participation in sales fairs etc. the perspective follows that of an internationalisation process in stages, of which the first stage is that of simple export. However, for SMEs wanting, for instance, to engage in internationalisation by collaborating with foreign companies such policy measures will not be sought. It is concluded that support measures could gain effectiveness if they were reorganised and that it would be advisable to focus on the entrepreneur's experience and on developing his/her qualifications, including networking capabilities, rather than on the characteristics of the firm.

There are several examples of policy measures that provide SMEs with a direct and active support to exporting. These types of programme often combine access to information, development of relevant competences and 'hands-on-service' in the form of individual consulting. In other words, these types of programme typically have a holistic approach to the challenge of becoming an exporting SME.

These types of programme are designed for a target group of SMEs with no international experience. The Spanish programme presented in Textbox 6.2 is an example of such a programme that has been widely employed. Other programmes target SMEs that want to start exporting to a country in which they are not currently active. The Dutch programme 'Starter programme for foreign markets' (Programma Starters Buitenlandse Markten) is an example.

**Textbox 6.2 Introduction Plan to Foreign Promotion, PIPE 2000 (Plan de Iniciación a la Promoción Exterior)**

The **responsible organisations** are The Spanish Chambers of Commerce, Spanish Institute of Foreign Trade (Instituto Español de Comercio Exterior, ICEX), Regional Governments and the European Commission as supporting (co-financing) organisations.

**Overall aim:** The programme aims to increase and consolidate the number of Spanish exporting SMEs. PIPE 2000 aims to induce a change in the SME culture along with greater involvement and interest in exporting. An initial goal was to turn 2 000 Spanish SMEs into regular exporters by 2000, which was met.

**Support provided:** Any SME willing to export can obtain all the relevant support to start its foreign activities. They benefit both from the advice of Spanish institutions for foreign promotion (the aforementioned responsible organisations) and the help of a specialist from outside the enterprise. The services provided include:

- Financial support covering 80 % of expenses incurred during the two years of the programme
- Individualised and specialised advice
- Complementary services designed especially for the SME such as translation, insurance, financial services, information, training and promotion.

The programme is structured around three stages that last two years:

- 1 Self-diagnosis of Competitive Position and Internationalisation Potential (2 months).
- 2 Definition of the Internationalisation Process and Market Research (6 to 8 months - 80 hours of individual tutorials).
- 3 Implementation of an Internationalisation Plan (14-16 months - 40 hours of individual tutorials).

Once the three stages have been completed and participant SMEs have started exporting, the PIPE 2000 offers them a monitoring programme aimed at guaranteeing their consolidation as regular exporters.

**Size of the programme and experience:** Since it started in 1994 and during the first five years, i.e. up until 1999, 2 135 Spanish SMEs have been effectively supported. In the period 2000-2003 (January 27th), there were 1 374 beneficiaries. The budget for the 2000-2006 period amounts to more than € 75 millions.

Source: PIPE Web site, <http://www.icex.es/pipe2000/pipe2000.html> and interview with David García, Head of the PIPE 2000 Programme at the High Council of Spanish Chambers of Commerce.

64 Ibeh, K.I.N., Toward a Contingency Framework of Export Entrepreneurship: Conceptualisations and Empirical Evidence and Fischer, E. & Reuber, Targeting Export Support to SMEs: Owners' International Experience as a Segmentation Basis, Small Business Economics 20, the Netherlands, 2003.

In addition to the more common policy measures, some countries have specific programmes for promoting international, technological collaboration. The Irish Technology Transfer and Business Partners Programme<sup>65</sup> is particularly interesting, because, as opposed to most of the other policy measures, it helps establish lasting co-operation between companies in different countries.

The programme was initiated more than ten years ago and it is managed by Enterprise Ireland. Its aim is to help Irish SMEs and overseas companies to develop mutually profitable business alliances. It begins with an assessment of the client's strategic partnership objectives. Then, the agency searches for potential partners and arranges introductions. The agency can also assist with problems that arise because of differences in business and legal environments, language and culture. Likewise, the agency also assists overseas companies that seek to form partnerships with Irish companies. Since the beginning of the programme, over 300 partnerships have been formed between Irish SMEs and companies around the world. Around 40 new partnerships are formed each year.

The potential significance of a support programme to assist in identifying foreign business partners is emphasised by a recent cross-national survey.<sup>66</sup> This is a survey of 21 German and U.K. SMEs with a joint venture in China. The survey concludes that a key to success in a joint venture is the choice of the right partner. However, this is often a great challenge for SMEs, and a policy implication of the study is therefore that assistance is required for SMEs to locate and select appropriate business partners.

## 6.6. Success factors for SME policy measures

If a policy measure is to encourage internationalisation of SMEs successfully, it should be designed to take into account the barriers and problems identified above and it should be organised in such a way that it enables the SMEs to benefit from the programme.

One way to investigate the success factors of the identified policy measures would be to look at programme evaluations. However, there appears to be very few evaluations of the identified policy measures.

The findings in this report (based on both country-specific and international studies referred in Chapter 4 and the previous sections in this chapter) point to four elements as crucial for the success of a policy measure in the field of internationalisation:

- Firstly, managers of SMEs typically have limited time and management capacity. A policy measure should offer to perform some of the practical tasks on behalf of the manager, especially in the case of SMEs with no international experience.
- Secondly, studies indicate that SMEs often need specific, targeted support. The services provided should be 'customised' i.e. be tailored to the problems of the individual company. Such targeted support might for instance be assistance in identifying an appropriate foreign business partner.
- Thirdly, one of the key findings of this report is that internationalisation is more than just exporting. Policy measures, whether general or company-specific, should therefore comprise all the different approaches to internationalisation and the support should include, not just exporting and FDI, but also other activities, e.g. collaboration, foreign sub-suppliers, etc.
- Finally, the fact that SMEs with only foreign suppliers perceive external barriers to internationalisation to almost the same extent as exporting SMEs also suggest the need for policy measures to address internationalisation in a broad manner.

<sup>65</sup> The Technology Transfer & Business Partnerships also manages Ireland's Innovation Relay Centre within Enterprise Ireland. The Innovation Relay Centre is one of a network of 68 Innovation Relay Centres (IRCs) spanning the EU and associated countries. The objective of the IRC is to help Irish SMEs identify solutions to their technological problems and access European technology by promoting both inward and outward technology transfer, <http://irc.cordis.lu/>.

<sup>66</sup> Kirby, D. & Kaiser, Joint Ventures as an Internationalisation Strategy for SMEs, *Small Business Economics* 21 (3): 229-242, the Netherlands, 2003.



# Chapter 7

## Conclusions

Policy measures to promote the internationalisation of SMEs need to adopt a holistic approach, based on the value chain perspective, to the internationalisation process and target the individual SME. The holistic view that is needed relates to three particular findings:

- 1 Internationalisation is much more than exporting or importing. Activities such as cross-border co-operation, alliances and networks are increasingly important. This tendency is perceived as a fundamental and structural feature and is therefore expected to be strong in the longer term. A significant number of SMEs internationalise to access know-how and/or technology or labour. The ENSR Enterprise Survey shows that this is the second most frequent motive for SMEs to internationalise. Sales are no longer the all-dominating motive for international activity. The Internet and new facilities for fast and easy communication and collaboration have been key factors in allowing more complex partnerships.
- 2 The traditional stage theory (describing internationalisation as a gradual process beginning with sporadic exporting and ending with foreign subsidiaries) is being challenged both by the concept of 'born globals' (enterprises oriented towards internationalisation at an early stage) and the fact that internationalisation comprises a whole range of cross-border activities, mutually supporting each other, rather than being successive stages in a gradual process. A broader view of the internationalisation strategy is also needed to analyse the internationalisation activities resulting from further integration of activities other than sales/trade.
- 3 Managers of SMEs often have limited time and management capacity. A policy measure should not only provide export promotion support, but also consider offers to coach the manager and perhaps even perform some of the practical tasks involved in the process. Studies indicate that SMEs often need 'customised' support, which includes for instance assistance in identifying an appropriate foreign business partner for a joint venture or collaboration. Moreover, recent studies indicate that SMEs' awareness of support measures may be low due to a 'stages approach' to internationalisation. The studies suggest that for policy measures to be effective there is a need to focus on the experience of the entrepreneur and on developing his/her qualifications.

The need for individual and customised support for SMEs is particularly emphasised in a German study. This study shows a significant gap between the acknowledged need in SMEs for planning of international activities and the real actions taken in relation to international activities. This deficit, in preparatory actions for entering a foreign market or engaging with foreign partners, is a challenge for SMEs themselves. In this respect policy measures can provide support to SMEs, particularly at the early stages of the process.

However, almost 60 per cent of the non-internationalised SMEs in the ENSR Enterprise Survey have not even considered internationalising. The fact that so many SMEs do not even consider internationalising may indicate a need for raising awareness among SMEs of the benefits that may be obtained from international activities. Internationalisation is often accompanied by improved performance and competitiveness of SMEs, as indicated by several international studies as well as the ENSR Enterprise Survey.

Development towards more complex forms of internationalisation and a customised approach to the different SMEs' international activities is advisable. In order to raise the awareness among SMEs of the opportunities related to internationalisation, policy measures should widen their traditional scope. Rather than focusing exclusively on export launches or general information platforms, support measures should have a broader perspective and be geared towards assisting the SMEs in the choice of the strategy and of the individual mix of international actions to take.



# Annex I

## The position of SMEs in Europe-19

### 92 % of all European enterprises have less than 10 employees

In 2003, there are about 19.5 million enterprises in the European Economic Area (EEA) and Switzerland, providing employment for almost 140 million people. Some 92 % of these enterprises are micro (0-9 employees), 7 % are small (10-49), less than 1 % are medium-sized (50-249) and only 0.2 % are large enterprises (250+). Of all these enterprises 18.7 million are established within the European Union. Just over two thirds of all jobs are in SMEs, so almost one third of all jobs is provided by large enterprises. Within SMEs, the major share of employment is in micro enterprises, enterprises employing less than 10 employees (56 %).

The size-class distribution of employment differs, however, between countries. For example, the share of micro enterprises in total employment is 57 % in both Italy and Greece.

On the other hand, the share of large enterprises in total employment is 41 % in the United Kingdom and even 45 % in Iceland, versus 30% on average.

**Table I.1: The basic facts about SMEs and large enterprises, in Europe-19, 2003**

		SME	Large	Total
Number of enterprises	(1 000)	19 270	40	19 310
Employment	(1 000)	97 420	42 300	139 710
Occupied persons per enterprise		5	1 052	7
Turnover per enterprise	Million €	0.9	319.0	1.6
Share of exports in turnover	%	12	23	17
Value added per occupied person	€ 1 000	55	120	75
Share of labour costs in value added	%	56	47	52

Source: Estimated by EIM Business & Policy Research; estimates based on Eurostat's Structural Business Statistics and Eurostat's SME Database. Also based on European Economy, Supplement A, May 2003 and OECD: Economic Outlook, No. 71, June 2003. Since a different source has been used, data presented is not directly comparable with data presented in earlier reports of the Observatory of European SMEs.

### The average European enterprise employs 7 people

On average, an enterprise in Europe - even including all very large enterprises- provides employment to 7 people; the average for SMEs is only 5 people. However, this varies between 3 people in micro enterprises, and over 1 000 in large enterprises. Countries differ significantly with respect to the scale of their enterprises. For example, the average number of occupied persons per enterprise varies between 2 in Greece, and 12 in the Netherlands.

Medium-term developments (1988-2003) show that in SMEs employment increased, whereas in Large Scale Enterprises (LSE) employment decreased.

Real turnover and value added growth has been smaller in SMEs than in LSEs. However, as labour productivity grew only moderately in SMEs, employment growth was larger in SMEs than in LSEs. In fact, employment in SMEs grew, while in LSEs, it decreased. These patterns can be observed in many individual sectors of industry (except extraction and producer services, which both are LSE-dominated sectors).





## Annex II

# Set-up and structure of Survey

### II.1. Introduction

The ENSR Enterprise Survey 2003 is designed to make uniform data on SMEs available from nineteen European countries. This enables the Observatory of European SMEs, in addition to using Eurostat and other secondary data, to make comparative analyses based on recent and comparable SME data. Data have been collected from enterprises in each of the 19 countries covered, i.e. the 18 Member States of the EEA and Switzerland.

Interviews were conducted using the CATI-system of Intomart. CATI stands for Computer Assisted Telephone Interviewing. The overall design and implementation of the stratification, the questionnaire and the fieldwork were done in close collaboration between staff from EIM Business & Policy Research in the Netherlands, partners in the ENSR network and Intomart.

In this annex the sample size and stratification plan of the ENSR Enterprise Survey 2003 are described. This will foster a proper use and interpretation of the data that have been collected. The 2003 ENSR Survey of SMEs was carried out from April-August 2003.

### II.2. Sample size

The size of the sample was determined by considering the need to report on dichotomous variables at country and size class level, with reasonable accuracy and confidence. Statistical theory shows for dichotomous variables that if sample errors are not to exceed  $\pm 10\%$ , at a confidence level of 95 % a total sample size of about 90 is needed for that level. This applies to estimates at the country-size class level combined. As three size classes are distinguished in nineteen countries, the minimum required sample size can be calculated as  $3 * 19 * 90 = 5\,130$  interviews. Estimates at the country or size class level separately are of course much more precise at the same level of confidence, as there are many more respondents at these levels.

To allow additional analyses, i.e. by various subgroups to be distinguished in the group of sampled enterprises, the planning did not aim at 5 130 interviews but at about 50 % more: 7 745 interviews. Actually even 7 837 completed interviews were obtained.

### II.3. Stratification plan

Interviewing 7 745 SMEs means covering about 0.04 % of all SMEs. A simple random sample would imply that in total only about 65 medium-sized enterprises (spread over nineteen countries and seven sectors) could be expected in the sample. Obviously this would be insufficient to reach any valid conclusion about the group. Therefore a disproportionately stratified sample is used; this means interviewing less than a proportional number of smaller enterprises and more than a proportional number of larger enterprises. Consequently, observations from the survey must be weighted in order to arrive at representative results.

The stratification of the ENSR Enterprise Survey 2003 is defined in terms of industry (i), enterprise size (s), and country (c). The stratification aims to minimise the standard deviation of the weights used in raising sample results to population levels, taking account of the fact that, in many cases, data by country and/or by enterprise

size class or by sector of industry are presented. In order to guarantee a sufficient number of observations for these subsets of the European enterprise population, the following constraints A to E have been imposed:

- A. In each country/size class combination: at least 100 observations.
- B. In each industry/size class combination: at least 100 observations.
- C. In each country/industry combination: at least 35 observations.
- D. In each individual industry/size class/country combination: at least 2 observations.
- E. In each individual industry/size class/country combination: an upper limit of 10 % of the stock of enterprises.

Restriction E supersedes the other restrictions if conflicts arise. So if 100 observations at the country/size class level (restriction A) would exceed 10 % of the stock of enterprises, the 10 % was set as an upper limit.

The stratification plan that resulted from this procedure is presented in Table II.1, by country and size class (for all sectors).

**Table II.1 Stratification plan: country by size class (for all sectors)**

Country	Micro (0-9)	Small (10-49)	Med.-sized (50-249)	Total
Austria	107	100	99	306
Belgium	172	99	99	370
Denmark	139	99	100	338
Finland	103	101	99	303
France	461	100	100	661
Germany	493	100	100	693
Greece	162	100	100	362
Iceland	99	97	13	209
Ireland	100	101	100	301
Italy	607	99	100	806
Liechtenstein	139	22	3	164
Luxembourg	100	101	45	246
Netherlands	132	101	100	333
Norway	134	100	99	333
Portugal	164	99	101	364
Spain	363	100	100	563
Sweden	153	99	100	352
Switzerland	116	99	99	314
United Kingdom	527	100	100	727
Total	4 271	1 817	1 657	7 745

Source: Sample optimisation developed by EIM.

The stratification procedure results in a sample of 4 271 micro firms, 1 817 small firms and 1 657 medium-sized firms (see Table II.1). Although there are many more micro firms than larger firms in this sample, the differences in sample size between the three distinguished size classes are much smaller than the corresponding differences in the population. In other words, micro enterprises are still underrepresented in our sample, while small and especially medium-sized enterprises are over represented.

Disproportionate stratifications have also been made regarding country. The sample size ranges from 164 for Liechtenstein to 806 for Italy. Again, while the sample size is larger for large countries, small countries are over-represented in the survey. Without this overrepresentation, it would not be possible to make valid statements concerning the smaller countries.

The overrepresentation of certain countries, sectors and size classes is corrected by weighting the survey results. Therefore, all percentages in text, tables and figures in this report refer to weighted results.

## Annex III

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## More information on Enterprise DG

Additional useful information on the work of Commissioner Erkki Liikanen and the Enterprise Directorate-General is available through printed publications and on the web.

**Commissioner Erkki Liikanen, responsible for Enterprise and the Information Society:**

[http://europa.eu.int/comm/commissioners/liikanen/index\\_en.htm](http://europa.eu.int/comm/commissioners/liikanen/index_en.htm)

**Enterprise DG on the web:**

[http://europa.eu.int/comm/dgs/enterprise/index\\_en.htm](http://europa.eu.int/comm/dgs/enterprise/index_en.htm)

**CORDIS (Community Research and Development Information Service):**

<http://www.cordis.lu>

**Enterprise DG work programme:**

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**Enterprise DG's printed publications:**

<http://europa.eu.int/comm/enterprise/library/index.htm>

### *Enterprise Publications*

**Enterprise Europe** is a free-of-charge newsletter published quarterly in the 11 Community languages by the Enterprise Directorate-General. It covers the whole range of Enterprise DG's work, announcing new initiatives as well as providing practical information.

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**CORDIS focus** is published twice a month in English, French, German, Italian and Spanish. It provides a review of the main developments in all aspects of European Union research and innovation activities, covering general policy developments, programme implementation, calls for tenders and results, events, legislative activities, and much more.

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**European Trend Chart on Innovation newsletter.** The Trend Chart project develops practical tools for innovation policy makers in Europe. It pursues the collection, regular updating and analysis of information on innovation policies at national and Community level. The newsletter is published quarterly in English, French and German.

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