

## Drivers of SME Internationalisation

*Background Study for the European Competitiveness Report 2014*

### What we knew about SME internationalisation in the EU:

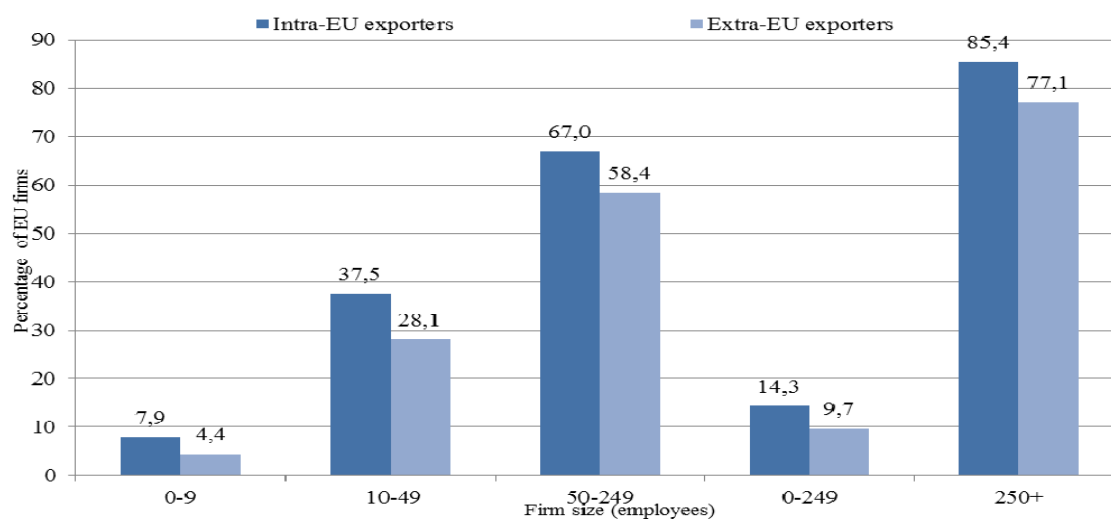
- Small and medium-sized enterprises (SMEs) comprise over 99% of all firms and 60% of total output in the EU.
- The level of internationalisation of SMEs remains low, with majority of SMEs oriented towards domestic markets.
- Small and micro enterprises in particular show the greatest scope for increased international activity.

### What we wanted to learn:

1. What are the key drivers that influence the internationalisation of SMEs and their performance in international markets?
2. What are the main internationalisation modes for SMEs and how do these differ between different size classes and activity sectors?
3. What is the relative international performance of different SME size classes and how does this impact on firm growth?
4. What are the main factors influencing export propensity and participation rates for SMEs and the firm characteristics associated with these?

### What we discovered:

- The results show that the barriers to internationalisation are systematically higher for SMEs than for larger companies and that the size of SMEs is crucial to the level of international activity. Micro enterprises in particular have significantly lower export participation rates compared with the other size-groups of firms. The findings show that both export participation and export intensity increase with firm size from micro enterprises through small and medium-sized enterprises to large firms.
- Among manufacturing SMEs in the EU, 14.3 per cent export goods to EU countries and 9.7 per cent do so beyond the EU. One can observe the increase in export participation which increases with firm size, from 4.4 per cent of micro enterprises to 77.1 percent of large firms exporting outside the EU. These results are summarised in the graph below showing differences between intra- and extra-EU exports by size class.



Note: Contains data for 23 EU countries in 2010 (EU-28 excluding IE, BE, EL, HR and MT); excludes financial services, agriculture and non-business public services. Source: Eurostat, TEC database, New Cronos.

- SMEs tend to enter foreign markets primarily as exporters due to lower investment requirements and associated risk. Firm characteristics such as industry affiliation, age and destination play an important role in SME export behaviour. Export propensity of SMEs varies markedly across industry affiliations, with higher participation rates in manufacturing and in software and business services.
- The age of the SMEs is impacting upon the developments in their internationalisation: the older the SME, the more internationalised it is likely to be, and thus the more likely it is to export and to invest abroad. There are some exceptions, particularly in ICT and business services where younger firms are often also internationally active.
- The study also revealed that productivity levels of SMEs, technological innovation, R&D activities, skill intensity and ICT capacities are all strongly positively related with export participation levels of SMEs. Overall, productive firms are more likely to be internationally active irrespective of the mode of internationalisation.
- The analysis also provides evidence on the importance of external factors in influencing the propensity to export. Export participation of SMEs is strongly influenced by home country-characteristics, with higher export and business regulations in the home market leading to lower export participation rates.
- New empirical results show that export intensity of SMEs is significantly positively related with both export promotion measures and export credits. Host country factors are also significant in SME internationalisation including market size, cultural factors including language, and geographical distance. SMEs are more sensitive to these differences than larger firms.

### *Policy Implications*

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- The findings suggest that successful internationalisation of SMEs depends on a mix of direct and indirect policies rather than on a single policy instrument. Creating favourable framework conditions, namely supporting innovation and R&D activities, further investments in ICT infrastructure, will help to increase the internationalisation activities of SMEs. EU member countries should continue to reduce export regulations and offer better business climate conditions for SMEs.
- Although EU countries have made efforts to reduce the administrative burden on SMEs and generally reduced the time and costs associated with starting a business during recent years, the cost to export has not seen the same progress. Focus on measures to improve the administration of exporting or investing abroad, such as harmonisation of administration procedures and processing times in relation to exporting, should prove helpful.
- Another area where improving framework conditions could be beneficial, as it indirectly affects the capacity of SMEs to internationalise, relates to certain elements of the infrastructure. Improving the ICT and internet infrastructure as well as the level and quality of trade-related infrastructure and related policies should be beneficial in indirectly promoting the internationalisation of SMEs.
- Besides improving framework conditions, certain targeted policy measures may be appropriate in aiming at eliminating certain market failures hindering the internationalisation of SMEs, and addressing those SME subgroups which are hit hardest by these. The analysis has also underlined the heterogeneity of SMEs in their degree of internationalisation with respect to size, age, industry affiliation, and ownership, as well as firm-specific advantages such as productivity, innovation, skills and ICT capabilities. This suggests that less focus should be put on this cohort as a whole, but rather on small firms and medium-sized firms separately, particularly when formulating measures offering direct assistance in the form of information, financial and operational support.

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