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Ghent University and Katholieke Universiteit Leuven

RESEARCH REPORT

INTERNATIONALIZATION OF SMEs

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FLANDERS DISTRICT OF CREATIVITY

Flanders District of Creativity is the Flemish organization for **entrepreneurial creativity**. It was founded in 2004 by the Flemish Government as a non-profit organization and enjoys broad support. Flemish businesses, academia, and public institutions use Flanders DC as a platform for cooperation in the pursuit of a more creative Flanders region.

Creativity is the key ingredient in making companies more successful and in helping regional governments ensure a healthy economy with more jobs. Flanders DC inspires creativity and innovation:

1. by learning from the most **creative regions** in the world,
2. by igniting **creative sparks** in everyday life and business, and
3. by providing **research, practical business tools and business training**, in cooperation with the Flanders DC Knowledge Centre.

1. Districts of Creativity: Inspiration from the most creative regions

Responses to global challenges are best found within an international network of excellence. With the single aim of learning from the very best, Flanders DC aims to unite the most dynamic regions in the world within the 'Districts of Creativity' network. Every two years, Flanders DC convenes the Creativity World Forum, bringing together government leaders, entrepreneurs, and knowledge institutions to exchange ideas about how to tackle pressing economic problems and make their regions hotbeds for innovation and creativity.



November 15-16, 2006 - Ghent, Belgium



*: Candidate members

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Flanders DC encourages entrepreneurs and citizens to look ahead and find creative solutions today for tomorrow's problems. Flanders DC has developed an idea-generation tool to encourage people and organizations to take the first step toward innovation. In addition, Flanders DC runs a general awareness-raising campaign entitled "Flanders' Future".



3. The Flanders DC Knowledge Centre: Academic support



The **Flanders DC Knowledge Centre** serves as a link between Flanders DC and Vlerick Leuven Gent Management School. Each year, the Flanders DC Knowledge Centre publishes several reports and develops various tools, case studies and courses. All these projects focus on the role of creativity in a business environment and identify obstacles to, and accelerators of competitive growth.

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- **Ondernemen.meerdan.ondernemen**, an online learning platform
- **Creativity Class** for young high-potentials
- **Flanders DC Fellows**, inspiring role models in business creativity
- **Creativity Talks**, monthly seminars on business creativity and innovation



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In a globalizing economy, regions and firms are competing on an international level. Internationalization contributes to the economic development of nations, in developing national industries, improving productivity and creating employment. Small firms play an important role in this process. **Export-oriented entrepreneurship contributes more strongly to macro-economic growth** than entrepreneurial activity in general.

Nowadays, internationalization affects all firms large and small. Increasingly, **small and medium sized enterprises (SMEs) are confronted with international competition and are forced to play a role in international markets.** This internationalization can take many forms, such as import, export, foreign direct investment (FDI) and international collaboration. For many firms, access to know-how or technology is an important motive for going abroad. Several international studies have indicated that **internationalization is often accompanied by improved performance and competitiveness of SMEs.** As a large number of SMEs in Flanders are not internationally active, **Flanders has a large potential for growth through internationalization of its SMEs.** Emerging markets like the new EU member states and China provide new opportunities, as do sectors such as creative and knowledge intensive industries.

The changing business environment creates new opportunities and incentives for SMEs to internationalize. On the one hand, **trade liberalization opens up new opportunities.** On the other hand, it also confronts domestic firms with the threat of international competition. **SMEs are increasingly facing foreign competition and need to respond to these changes of their strategic environment.** This not only implies adjusting their domestic strategy, but increasingly forces firms to go abroad.

Exporting can lead to increasing productivity, through **economies of scale.** FDI may provide a firm with **new know-how and technologies,** which can be combined to develop new competitive strengths. Still other firms may seek access to **cheap inputs,** such as raw materials or labor. As large firms increasingly outsource parts of their supply chain, opportunities for SMEs arise to internationalize through co-operation with large firms. Regardless of the motives, **internationalization provides firms with opportunities to improve productivity and increase their chances of survival.**

Although internationalization may be necessary for firms to grow and survive in the long run, it does not guarantee firm survival. The risks and costs involved in the process are substantial. Smaller firms find it hard to overcome these challenges, and often suffer from their limited size and resources. SMEs not only have more difficulties in financing their international activities, they often have limited international experience in their management team. Nevertheless, **advances in telecommunication and other technologies have considerably reduced the costs and risks involved in internationalization.** This makes it possible for an increasing number of small and medium sized firms to exploit opportunities in foreign markets.

Smaller firms traditionally focused on their domestic market, and a majority of SMEs will most likely continue to do so in the future. However, an increasing share of SMEs is internationally active. About 25% of manufacturing SMEs in OECD countries are active in international markets. These SMEs contribute between 25% and 35% of global manufacturing exports. In general, **internationally active**

SMEs experience faster growth than purely domestic firms. Nevertheless, the internationalization of SMEs is often limited, both in geographical scope and in terms of the share of international versus domestic activities. This implies that SMEs still have a large untapped potential to grow through internationalization.

Policy can play an important role in assisting SMEs in their internationalization process. A large number of **SMEs have never considered internationalization.** The first policy objective should be targeted at increasing the awareness about the benefits of internationalization within this group of entrepreneurs. Policy measures should be aimed at **reducing entry barriers and lowering the cost of international expansion**, such as the protection of property rights, and transaction costs. Another often mentioned barrier to internationalization is regulations and red tape. Therefore, policy measures should aim at reducing these barriers, rather than further increasing the administrative burden SMEs already have to deal with. Other important barriers relate to lack of information and finding reliable partners.

Firms in different stages of internationalization have different needs for government export assistance. Therefore, **support should be tailored to firms with different degrees of export commitment**, rather than offering generic government assistance to all firms. For those firms that do not export, a distinction should be made between those that are ready to export and those firms that are not.

Policy frameworks need to be flexible enough to respond to the **increasing complexity and uncertainty SMEs face while competing internationally.** There should be policy initiatives to develop an international entrepreneurial environment. Support agencies should consider other forms of internationalization than export. Since joint ventures are an emerging internationalization strategy for SMEs, support programs could play an important role in **assisting SMEs in identifying foreign business partners.**

Programs providing direct and active support to SMEs should combine a number of factors, such as **access to information, competency development and hands-on, individual service.** Policy should focus on developing the entrepreneurial competencies and international orientation. The necessary skills and knowledge to manage globally need to be developed, and networks and relationships need to be supported.

Most countries offer standard information services and promotion, such as support for participation in trade fairs or trade missions. A more effective support measure would be more customized support, such as individual counseling. This may include **advice on export development, the establishment of subsidiaries abroad, competence development, the identification of partners and legal advice.** However, there seems to be a significant gap between the need SMEs have for planning their international activities and the actions in relation to these activities. Therefore, SMEs could benefit from assistance in **choosing, planning and deploying the right strategy.** Support agencies should not limit their role to information services and financial support. Follow up is needed to assess the impact of the assistance on the SME's internationalization performance.

While government support is important, **whether or not an SME will internationalize, will primarily depend on the entrepreneur.** Firms need to realize the possible benefits of internationalization and integrate this into their strategy. Although the barriers to internationalization have been reduced in

the past two decades, small firms still find it difficult to overcome the barriers that are still in place. In addition, internationalization brings about increasing risk and uncertainty, and **not all entrepreneurs are willing to take this risk**. When considering internationalization as a strategic option, the entrepreneur has often limited information about conditions in foreign markets. To overcome these obstacles, small firms often rely on the international experience of their network, such as their current buyers and suppliers.

An analysis of the external and internal factors should lead to the development of a strategy. Those firms that have the internal capabilities to face the risks and barriers of internationalization and incorporate internationalization in their strategy, still need to bring this strategy into practice. Choosing the right market, the appropriate timing and the optimal entry mode, are just some of the options to successfully implement an international strategy, and ultimately increase a firm's profits. The optimal scope of the international operations will depend on the **interaction between the strategic needs of the firm, its resources and environmental factors in both its home market and foreign markets**. While high tech firms may choose rapid internationalization and follow the international new venture approach, the stage theory may still be the most appropriate for firms in mature industries. The timing and risks involved in these approaches are different, and firms need to evaluate whether they want to reduce the risk and follow a conservative pattern, or need to capture market share fast before their technology becomes obsolete. The internationalization strategy must fit the firm's overall strategic objectives.

Despite the strategic importance and the possible benefits of internationalization, a large number of SME owners indicate they have never considered internationalization. Many others have considered internationalization as a strategic option for their business, but did not bring this into practice because they could not overcome the barriers associated with internationalization. The most important internal **barriers for SMEs are the costs involved in internationalization** and the characteristics of the products or services. **Laws and regulations and lack of financing** are the main external barriers for SMEs in Europe. While there are no considerable differences in terms of external barriers between Belgian and European SMEs, the **product's quality and specifications seem to be a much more important barrier for Belgian SMEs** than for their European counterparts.

Overall, the percentage of exporting and importing Belgian SMEs is higher than the European average. SMEs in Flanders and Brussels are more internationalized than SMEs in Wallonia. The most common mode of internationalization for Belgian SMEs is the combination of import and export. Export and import are much more common among older and larger SMEs than among young and small SMEs. Still, some recently established firms start exporting short after inception. These international new ventures are characterized by extremely high growth rates, and are most common in high technology sectors. In general, **SMEs in high tech sectors are more internationalized than SMEs in other sectors**.

Internationalized SMEs report faster growth in employment, value added and labor productivity. Especially in the years directly following foreign market entry, both exporting and importing SMEs experience very high growth rates. Despite the risks involved in internationalization, both import and export have a positive impact on firm survival.

In a globalizing economy, regions and firms are competing on an international level. Internationalization contributes to the economic development of nations in developing national industries, improving productivity and creating employment. However, research on the importance of export for national economies has strongly focused on large multinational enterprises. Recently, some studies have found links between internationally oriented entrepreneurship and economic growth. Hessels & van Stel (2006) find that export-oriented entrepreneurship contributes more strongly to macro-economic growth than entrepreneurial activity in general, both for highly developed countries and transition countries.

Nowadays, internationalization affects all firms large and small. Increasingly, small and medium sized enterprises (SMEs) are forced to play a role in international markets. This internationalization can take many forms, such as import, export, foreign direct investment (FDI) and international collaboration. For many firms, access to know-how or technology is an important motive for going abroad. Several international studies have indicated that internationalization is often accompanied by improved performance and competitiveness of SMEs. As a large number of SMEs in Flanders are not internationally active, Flanders has a large potential for growth through internationalization of its SMEs. Emerging markets like the new EU member states and China provide new opportunities, as do sectors such as creative and knowledge intensive industries.

The changing business environment creates new opportunities and incentives for SMEs to internationalize. On the one hand, trade liberalization opens up new opportunities. On the other hand, it also confronts domestic firms with the threat of international competition. SMEs are increasingly facing foreign competition and need to respond to these changes of their strategic environment. This not only implies adjusting their domestic strategy, but increasingly forces firms to go abroad. Exporting can lead to increasing productivity, through economies of scale. FDI may provide a firm with new know-how and technologies, which can be combined to develop new competitive strengths. Still other firms may seek access to cheap inputs, such as raw materials or labor. As large firms increasingly outsource parts of their supply chain, opportunities for SMEs arise to internationalize through co-operation with large firms. Regardless of the motives, internationalization provides firms with opportunities to improve productivity and increase their chances of survival.

Although internationalization may be necessary for firms to grow and survive in the long run, it does not guarantee firm survival. The risks and costs involved in the process are substantial. Smaller firms find it hard to overcome these challenges, and often suffer from their limited size and resources. SMEs not only have more difficulties in financing their international activities, they often have limited international experience in their management team. Nevertheless, advances in telecommunication and other technologies have considerably reduced the costs and risks involved in internationalization. This makes it possible for an increasing number of small and medium sized firms to exploit opportunities in foreign markets.

Smaller firms traditionally focused on their domestic market, and a majority of SMEs will most likely continue to do so in the future. However, an increasing share of SMEs is internationally active. According to the OECD (2000), about 25% of manufacturing SMEs in OECD countries are active in international markets. These SMEs contribute between 25% and 35% of global manufacturing

exports. In general, internationally active SMEs experience faster growth than purely domestic firms (OECD, 2000). Nevertheless, the internationalization of SMEs is often limited, both in geographical scope and in terms of the share of international versus domestic activities. This implies that SMEs still have a large untapped potential to grow through internationalization.

In this report, internationalization of SMEs will be approached as an essential part of a firm's strategy. The first chapter will highlight the importance of integrating the internationalization strategy in the overall strategy of the firm. To develop an appropriate strategy, firms should analyze the internal and external environment and match this with their capabilities. Possible risks and barriers should be identified and carefully offset with possible benefits. This will present the firm with different strategic options, according to the possible motives and benefits of different modes of internationalization.

In the second chapter, existing theories of SME internationalization will be discussed. As there is increasing evidence that SMEs are simultaneously involved in different types of cross-border activities, some traditional models seem to have lost relevance, at least for some types of SMEs.

Chapter three explores the link between internationalization and firm performance. Several empirical studies point to higher productivity levels of exporters, compared to non-exporters. However, there still is some ambiguity on the causality of this relationship. While it is clear that better performing firms start exporting, it is less obvious what the post-entry effects of export on performance are.

In chapter four, international data on SME internationalization are presented. These data show that the proportion of internationally active Belgian SMEs is higher than the European average. Data from a European survey also allow comparing the drivers and barriers to internationalization perceived by SMEs across countries.

Chapter five follows with comprehensive data on the internationalization of Belgian SMEs, both in manufacturing and services sectors. Next to comparing different modes and geographical scopes of international activities, the operating characteristics of exporting and importing Belgian SMEs will be discussed.

All the above not only has implications on SME owners and managers, but also on policy makers. Chapter six concludes with some policy recommendations.

SME: definition

Small and medium sized enterprises (SMEs) have been defined differently in different countries. Although there is no standard definition, in the US and Canada, SMEs are generally defined as firms with fewer than 500 employees. In Japan, different headcount ceilings are used for manufacturing (up to 300 employees), wholesale (up to 150) and retail (up to 50). The EU has adopted a uniform definition, which replaced the definitions of the member states. This new definition of SMEs was adopted by the European Commission in 2003, in order to develop efficient SME policies. This definition also enables the EU members and institutions to target real SMEs and to exclude firms that are part of larger groups of national and European support mechanisms. According to this definition, an SME is an enterprise with fewer than 250 employees and a turnover of no more than €50 million or a balance sheet total of no more than €43 million. Small enterprises employ less than 50 and micro enterprises less than 10 employees.

As SMEs represent 99% of all enterprises in the EU and employ 65 million people, their economic and social importance is enormous. About 92% of these enterprises are micro, 7% are small and less than 1% are medium-sized. On average, a European SME employs 5 people. Only 0.2% are large enterprises (250 or more employees), although these large firms provide one third of all jobs.

Choosing and developing the right strategy is a crucial decision that will impact the long term success of a business. For many SMEs, internationalization is not part of this strategy. When starting a new business, most managers' initial focus is on the local market. Expanding firm activities abroad may become an option once the firm has proven to be competitive in the local market. Few entrepreneurs start with the ambition of becoming a global leader in their market. This local or global mindset will be reflected in the firm's strategy.

Many SMEs do not pursue international success. For those that have further reaching ambitions, internationalization is often not explicitly mentioned in the strategy. Firms often internationalize because of external circumstances, e.g. responding to unsolicited orders from abroad. Even if this kind of ad hoc internationalization behavior may lead to a bright future in the global market, a more structured approach seems to be the preferred path to success in the long run.

To be successful in international markets, firms need to develop a strategy that fits their ambitions, their competences and their limitations. Internationalization resulting from a good strategy may prove to be more successful as firms have clear objectives, may be better prepared and can anticipate specific circumstances and intense competition in international markets. Developing the right strategy is a process that involves both an internal analysis of the firm's capabilities, and an external analysis of the environment in both the domestic and foreign markets. This section will focus on factors influencing a firm's decision to choose an international strategy and the development of such a strategy.

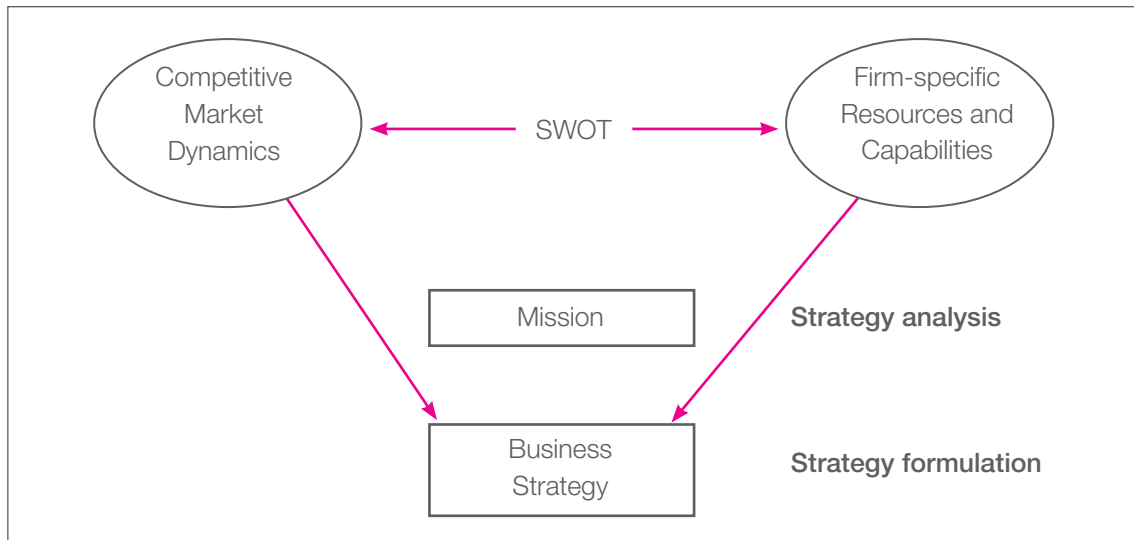
1.1 The strategy formulation process

The strategy formulation process in any firm starts from the purpose of the organization. *What is the ultimate goal of the firm?* This goal can be markedly different for different firms. Some firms' ultimate goal is to become world leader in a specific niche market; other firms have much more modest goals such as generating money for the entrepreneur to guarantee him and his family the desired standard of living. Whatever the goal, this is clearly translated into the firm's **mission**.

Starting from this mission the **business strategy** defines the plan of action to realize this mission. As firms do not operate in a vacuum but in a specific context, both external and internal factors can positively or negatively influence a firm in realizing its mission and should therefore be taken into account when drawing up this plan of action.

The **external analysis** provides the firm with information on important trends and evolutions that affect the industry it operates in. This analysis results in the identification of opportunities and also threats the firm will be confronted with when seeking to realize the mission. The **internal (company) analysis** on the other hand looks at the firm-specific resources and capabilities, and highlights the strengths and weaknesses of the firm that can help or hinder it in realizing its mission. The combination of this SWOT-analysis (i.e. analysis of internal strengths and weaknesses and external opportunities and threats) with the current performance of the firm and the mission, results in the formulation of different possible **strategic options**.

Figure 1 Hierarchy of business strategy



Source: Verweire & Van den Berghe (2004)

To be able to go to the implementation of the business strategy, clear choices have to be made among these options. The firm needs to decide on how it wants to position itself in the market. That means it has to take decisions on what products or services to offer, which group of customers to target and how (Abell, 1980). Markides (1999) sees this process of **choosing the right strategic position** as the essence of strategy.

1.2 Internationalization as a strategic option

During the strategy formulation process internationalization is one of the possible strategic options that companies should consider. Firms might opt for an international strategy for several reasons:

- 1) To gain access to new customers/markets for existing products or services
- 2) To gain access to valuable factors of production. These can range from cheap labor to specific raw materials or highly skilled labor.
- 3) To develop and leverage core competencies
- 4) To manage corporate risk

The last two decades several **environmental changes** have had a major impact on business and have changed the importance and potential of internationalization as a strategic option for companies. Advances in ICT have exponentially decreased the barriers for organizing business on an international scale. Moreover, several (blocks of) countries have adopted a more market-oriented economic system (e.g. Eastern Europe, India, China) thus bringing along new possible benefits for internationalization, but also new threats from increased competition. Many industries are characterized by shorter product life cycles and growing R&D investments, increasing the need for (international) collaboration and geographical expansion of a company's market.

The above mentioned forces make that **for all firms, large and small, in any industry the costs and benefits associated with internationalization have changed over the last decade.** This has not only led to the emergence of new phenomena, such as international new ventures, but also to an increasing number of incumbent firms that start internationalizing. In the next sections, both internal and external barriers and drivers for internationalization will be discussed.

1.2.1 Barriers to internationalization

Although many barriers to internationalization have decreased or have been removed over the past two decades, firms are still confronted with numerous obstacles when deploying activities in foreign markets. Some of these barriers are faced by all firms, large and small, while others may be specific for SMEs. The impact of these barriers on the internationalization decision of SMEs is often more fundamental than it is for large firms. Given the resource constraints of SMEs, overcoming these barriers may be a challenge that is simply too big. Not only do SMEs have limited assets and financial resources, they also have little or no international experience in their management team, limited knowledge of international markets, and limited international networks.

Many SMEs do not want to export, either because they do not have the necessary resources or they have no ambition to export, or the entrepreneur may not want to take the risks involved in internationalization. Those firms that do export are confronted with several obstacles obstructing the internationalization process. Westhead, et al. (2004) identify four types of obstacles to exporting:

- strategic obstacles
- operational and logistical obstacles
- informational obstacles
- process based obstacles

De Chiara & Minguzzi (2002) state that size is not restraining the international competitiveness of small firms and that sales abroad are not affected by firm size. They do however point out that small firms cannot enjoy all options in the internationalization process, because of structural handicaps such as limited financial resources. Moreover, some country specific factors may also hinder the internationalization of small firms. Because small firms are facing diseconomies of scale, the specialization of skills cannot reach a certain threshold. The main obstacles to internationalization of small firms are in the limited internal resources and capabilities, and thus not outside the firm.

Acs & Terjesen (2005) mention limited access to financial capital and imperfect information as most important barriers for new firms. De Maeseneire & Claeys (2007) find that SMEs face more severe financing constraints for FDI than for domestic projects. New ventures also face a liability of newness, limiting not only their access to financing opportunities, but also their access to information about labor, raw materials and output market conditions. Acs & Terjesen (2005) further state that barriers imposed by governments are often more economically damaging than those created by competitors.

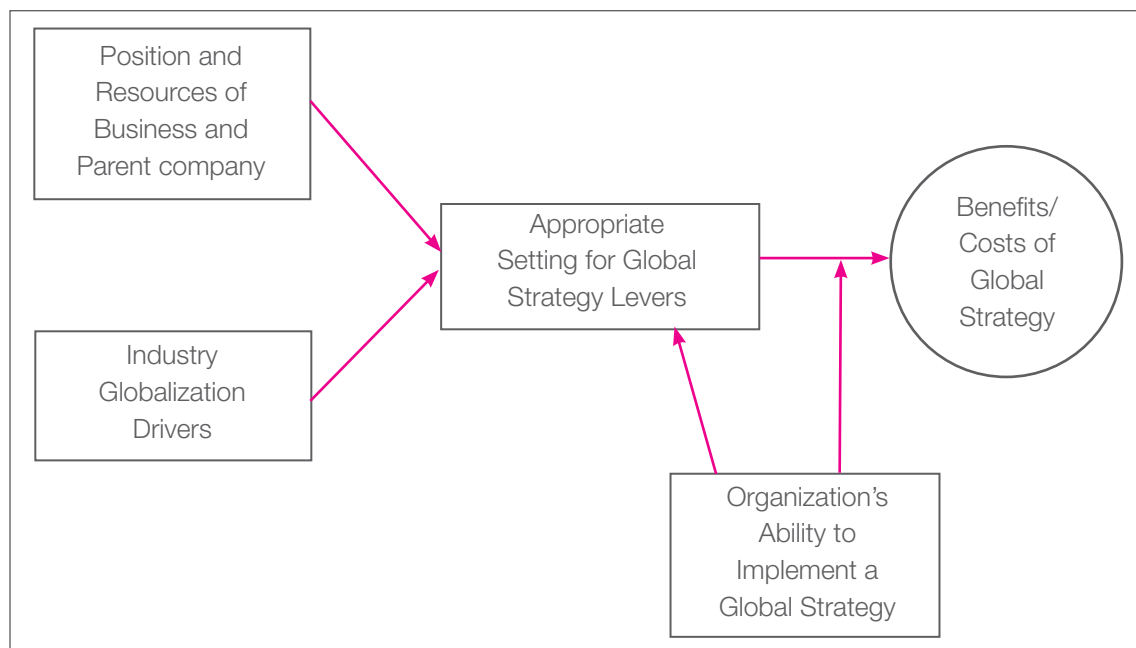
Leonidou (2004) found 39 export barriers in a review of 32 empirical studies of manufacturing SMEs. Although the impact of these export barriers is situation specific and depends on the managerial, organizational, and environmental background of the firm, certain barriers seem to

have a systematically strong obstructing effect on export behavior. Barriers such as information inefficiencies, price competitiveness, foreign customer habits, and politico economic hurdles seem to affect all SMEs, regardless of their idiosyncrasies.

1.3 Evaluating internationalization as strategic option

Despite the generally increased importance of internationalization as strategic option, the need for and exact potential of setting an international strategy is determined by specific drivers for internationalization at the industry level, as well as by the internal organization of the company and its ability to adopt an international strategy. Whether a firm can succeed in this, will depend on its ability to overcome the barriers it will face during the process.

Figure 2 A Framework for Global Strategy



Source: Yip (2003)

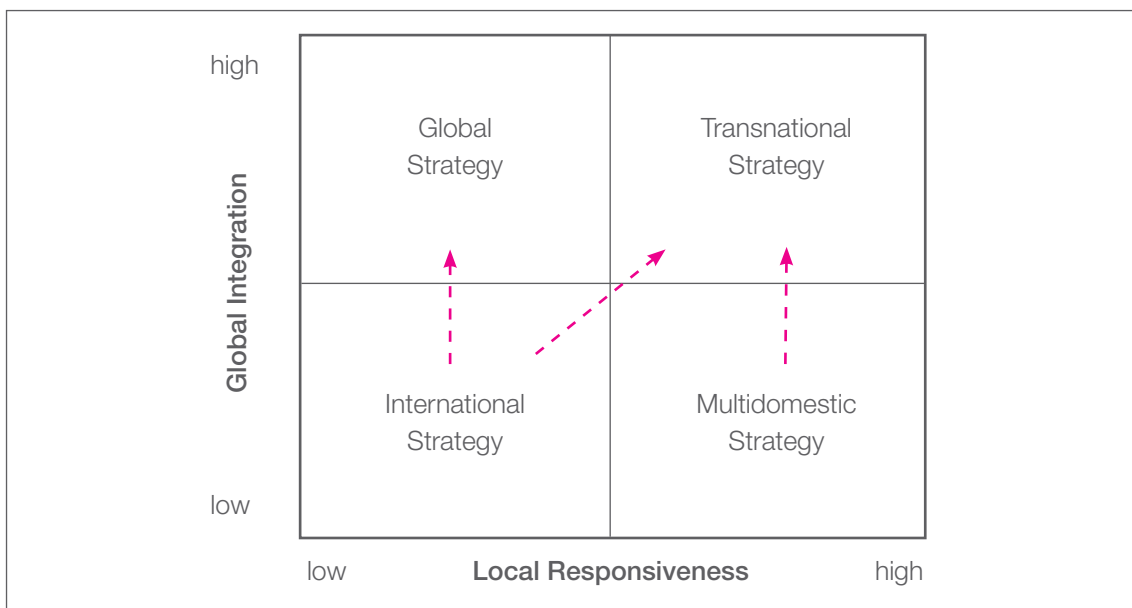
1.3.1 External evaluation

When evaluating an international strategy, the entrepreneur/manager should try to find the right balance between the level of local responsiveness and the level of global integration. Pressure for more global integration comes from e.g. possible cost benefits through standardization or economies of scale and scope. The need for more local responsiveness on the other hand comes from e.g. regional or country differences in consumer preferences, distribution channels or infrastructure. Depending on the importance of both forces, different internationalization strategies can be distinguished.

a. Scope of international strategy

Based on the external analysis, the entrepreneur can determine the focus and scope of the firm's international activities. This decision not only encompasses the global focus and the pace at which international activities are deployed, but also the way these activities are integrated within the company. Firms can have a global presence with far-reaching autonomy for the local business units in different countries, while other firms opt for a global strategy.

Figure 3 Multinational Strategy: Standardization versus adaptation?



Source: adapted from Doz et al. (2001)

On the one hand, firms are under pressure to integrate, as integration can lower costs through scale economies, leveraging core competencies and producing in low cost locations. On the other hand, firms seek local responsiveness, and adopt their products to respond to local needs and customer preferences in foreign markets. The trade-off between the benefits of global integration versus local responsiveness (which raises costs) will result in the firm's internationalization strategy. The choice between global integration (lower costs) and local responsiveness (increased revenues) is a fundamental strategic decision that will place firms in one of the four quadrants in Figure 3.

Increasing competition, shortening product life cycles, leveraging core competencies and developing new core competencies may all be drivers for firms to globally integrate activities. Global integration allows firms to exploit economies of scale and scope and to make use of local skills and know-how in the foreign markets. However, most SMEs are not globally integrated and choose either an international (export) or a multidomestic strategy, depending on the product life cycle and the local market needs. SMEs in markets that require high local responsiveness can move from a multidomestic to a transnational strategy, by integrating more value chain activities.

Yip (2003) identifies five dimensions that determine whether a company's strategy lays more toward the multilocal end or more toward the global end of the continuum.

- 1) Market participation
- 2) Product standardization
- 3) Activity concentration
- 4) Uniform marketing
- 5) Integrated competitive moves

The more activities can be concentrated and activities such as marketing can be done in a uniform way, the more the international strategy can be global.

At the industry level, companies have to consider four groups of "industry globalization drivers" – market, cost, government and competitive drivers – to assess the potential of setting a global strategy within their industry (Yip, 2003). **Market drivers** for globalization depend on factors such as the type of customers (existence of global customers), customer behavior (homogeneous needs) and structure of distribution channels (regional or globally integrated distribution systems). **Cost drivers** for globalization depend on the potential for economies of scale and scope, the potential for realizing sourcing efficiencies through globalization, differences in country cost and available skills. **Government drivers** for globalization might be favorable trade policies, the availability of compatible technical standards or common marketing regulations. **Competitive drivers** for globalization depend on the actions of competitors in the industry: are competitors globally organized?

Each group of drivers is different for each industry and can also change over time. Therefore, some industries have more potential for globalization than others. Moreover, within the value chain this potential can be different for different activities.

b. Drivers of internationalization

Drivers of internationalization are firm specific, as firms have different strategic goals. For most firms, one of the goals would be increasing its profitability and competitiveness. Therefore, cost considerations and market conditions play a crucial role in the internationalization decision. From a value chain perspective, firms internationalize to minimize costs while maximizing returns in purchasing, production and sales. Other firms may look for strategic assets, or collaboration with foreign partners to improve their competitiveness and increase their innovative capabilities. Access to know-how and technologies, international business relationships, knowledge sharing and financing possibilities are also important drivers for internationalization. Although the incentive to internationalize may be fundamentally different for each individual firm, the most important drivers for European SMEs to internationalize are gaining access to foreign markets, knowledge and technology (European Commission, 2004).

An interesting approach to these drivers is making a distinction between push and pull drivers. These drivers are influenced by a firm's competitive position and objectives, its external environment, its resources and capabilities and the strategy of the firm. Push factors are those drivers related to a firm's resources and competitiveness, domestic competition and the product cycle. On the

other hand, specific developments in foreign markets may pull firms to the benefits of international markets. Firms identify opportunities in international markets or segments, in which they can respond to an unfulfilled demand. The increasing globalization of some markets, is forcing firms to coordinate activities globally.

A limited home market, with limited growth potential, may push firms to seek expansion abroad. Fierce competition in the home market is another factor pushing firms abroad, trying to generate more revenues and to lower costs, either through exploiting economies of scale, or by lower production costs abroad. Existing intangible resources, such as technology and marketing skills, may push firms to expand operations abroad, as these can often be exploited without substantial extra costs in new markets. Government subsidies or export support may also provide push incentives.

Globalization and the increasing liberalization of international markets, combined with advances in information, communication and transportation technologies, pull firms to increasingly distant markets. Firms may also be pulled by foreign resources and partners, and often start internationalizing to serve the needs of current buyers, while the international presence of current suppliers may facilitate the internationalization process.

The impact of push and pull factors on the firm's internationalization process, will depend on firm characteristics, the orientation of the entrepreneur/manager and the specific circumstances influencing these forces (Etemad, 2004). The interaction of these forces can enhance or reduce the impact of each one of these factors. These combined interactions can stimulate or deter, and thus accelerate or decelerate the internationalization process. An example of such a mediated impact could be the combination of a small home market with the attraction of larger liberalized markets, that can interact with managers open to internationalization, as described by Coviello & Munro (1995).

Because of these intermediating factors, different firms have different responses to the same stimuli in the same environment. This not only affects the process of internationalization, but also its eventual success over time.

c. External barriers

External barriers originate from the home and host country environment the firm operates in (Leonidou, 2004). Different categories of external barriers are:

- procedural barriers
- governmental barriers
- task barriers
- environmental barriers

Procedural barriers relate to operating aspects of transactions with foreign customers. These barriers are caused by unfamiliarity with techniques and procedures, communication failures, and slow collection of payments and often have a high impact on export behavior.

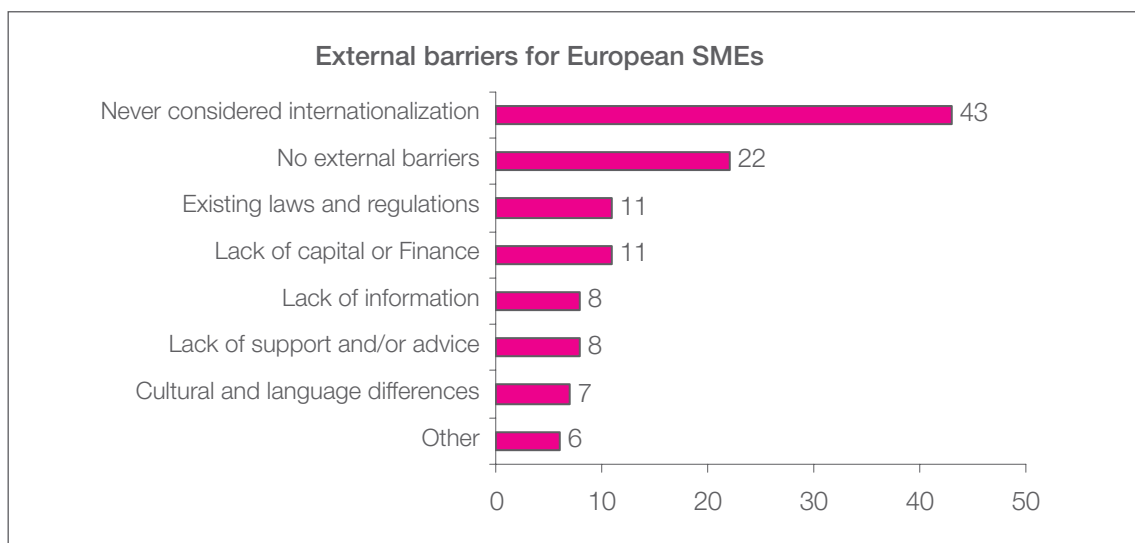
Governmental barriers are twofold. On the one hand, they include limited support and incentives for current and potential exporters. Another form of governmental barriers are restrictive regulatory frameworks and protectionist measures such as tariff and non-tariff barriers.

Task barriers refer to the firm's customers and competitors in foreign markets.

Environmental barriers focus on economic, political, legal, and socio-cultural environment of the foreign market.

According to a European survey (European Commission, 2004), the most important external barriers for European SMEs are laws and regulation and lack of capital or finance. Nevertheless, 22% of SMEs indicate they perceive no external barriers. Despite this fact, a large number of European SMEs (43%) indicate they never considered internationalization.

Figure 4 External export barriers for SMEs in Europe



Source: European Commission (2004)

1.3.2 Internal evaluation

Equally important in the evaluation of an international strategy is the internal structure of the company. What organizational structure does the company have? Who are the people working in the company? What is the company's culture? And what management processes are in place? These elements determine the ability to develop an international strategy. As the organization provides the vehicle through which the strategy needs to be implemented, the nature of the organization clearly affects the kind of strategy that can be implemented. The scale of the company (large versus small) can therefore substantially limit its ability to successfully pursue an international strategy.

SMEs not only face greater resource constraints compared to large firms, they also need to overcome greater barriers. On the other hand, smaller firms are often more flexible and can easily adjust their strategies. As empirical evidence clearly shows that many small firms have successfully implemented an international strategy, size alone cannot be considered an inhibitor of internationalization, although it can severely limit a firm's potential to internationalize.

a. Internal drivers

Cavusgil & Nevin (1981) classify the internal determinants of export behavior in four categories:

- differential firm advantages
- strength of managerial aspirations for various business goals
- management expectations about the effects of exporting on business goals
- level of organizational commitment to export marketing

Differential firm advantages are derived from the nature of the firm's products, markets, technological orientation, and resources. These factors are important in preparing the firm and in motivating its management, but not sufficient to initiate export.

The strength of managerial aspirations for various business goals, such as growth, profits, and market development are a second set of drivers. The importance that managers attach to internationalization is believed to be a direct determinant of a firm's export behavior.

Management expectations about the effects of exporting on business goals reflect the manager's knowledge and perceptions of possible risks and profitability of export. These expectations are also influenced by external factors, such as unsolicited orders from foreign buyers and fluctuations in exchange rates.

The level of organizational commitment to export marketing indicates the willingness to devote adequate resources to export-related activities. As exporting involves many new tasks and requires commitment of financial and managerial resources, this is a critical factor for an effective internationalization strategy.

b. Internal barriers

Internal barriers to internationalization are those obstacles associated with organizational resources and capabilities (Leonidou, 2004). Three types of internal barriers are identified:

- informational barriers
- functional barriers
- marketing barriers

Informational barriers relate to problems in identifying, selecting, and contacting international markets because of information inefficiencies. Examples of these barriers are locating and analyzing foreign markets, finding international market data, identifying foreign business opportunities, and contacting customers abroad. These barriers are considered important for both exporters and non-exporters, as they are critical in the export management decisions.

Functional barriers refer to inefficiencies in functions within the firm, such as human resources, production, and finance. These barriers generally have a moderate impact on export behavior. Examples are limited management time to deal with export, inadequate export personnel and shortage of working capital to finance export.

Marketing barriers include the firm's product, pricing, distribution, logistics, and promotion activities abroad. For many exporting firms, this is the largest problem area. Firms may need to develop new products or adapt existing products to suit customer preferences in foreign markets. However, such innovations would reduce possible economies of scale associated with exporting. Another important issue is setting the right price in relation to competition in international markets. Finding the right

distribution channel, and reliable foreign partners and representatives, is a major challenge for many exporting SMEs.

Although both internal and external barriers play a crucial role in export development, the impact of these barriers depends on other factors, such as characteristics of the firm's manager, the organization and the environment it operates in. Organizational factors also influence the perception of export barriers. Leonidou (2004) states that young firms are more sensitive to export barriers. Smaller firms are also more vulnerable to barriers associated with resource limitations, operating difficulties, and trade restrictions.

Because of this susceptibility to export barriers, very few small firms are inclined to export. Mittelstaedt et al. (2003) find that firm size is a necessary and sufficient condition for export success among small manufacturing firms in the US. They conclude that micro enterprises (in their definition firms with fewer than 20 employees) appear to be too small to acquire the necessary know-how and experience to engage in export.

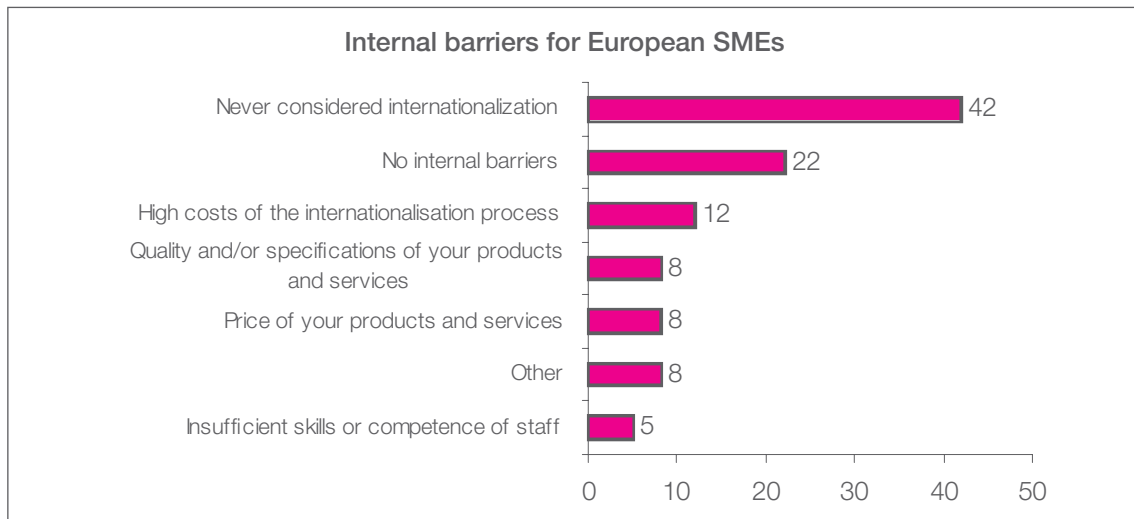
Only a marginal fraction of Belgian micro enterprises (less than 10 employees) are involved in international activities (about 5% in manufacturing and 10% in services). This proportion is three to four times higher for small firms (10-49 employees). Larger firms are more likely to be involved in international activities. Although there seems to be an apparent threshold of at least 10 employees, size alone does not inhibit internationalization, as evidenced by those micro enterprises that do export. Size may, however, limit the success of internationalization of these very small firms.

Internal barriers are often more controllable and easier to manage, as opposed to external problems taking place in foreign markets. The impact of these barriers is situation specific, and depends on the firm's particular managerial, organizational, and environmental characteristics. SME managers should adopt a proactive perspective towards these barriers, anticipate potential problems and take corrective measures when needed.

According to a European survey (European Commission, 2004), the most important internal barriers for European SMEs relate to the cost of the internationalization process. Other important internal barriers relate to the quality, price or specifications of the product or service. Similar to the external barriers, 22% of SMEs do not perceive any internal barriers. A large number of respondents (42%) indicate they never considered internationalization.

Evidence on the perceived barriers and drivers of internationalization for SMEs in Europe is further discussed in chapter 4.

Figure 5 Internal export barriers for SMEs in Europe



Source: European Commission (2004)

1.4 Implementing the internationalization strategy

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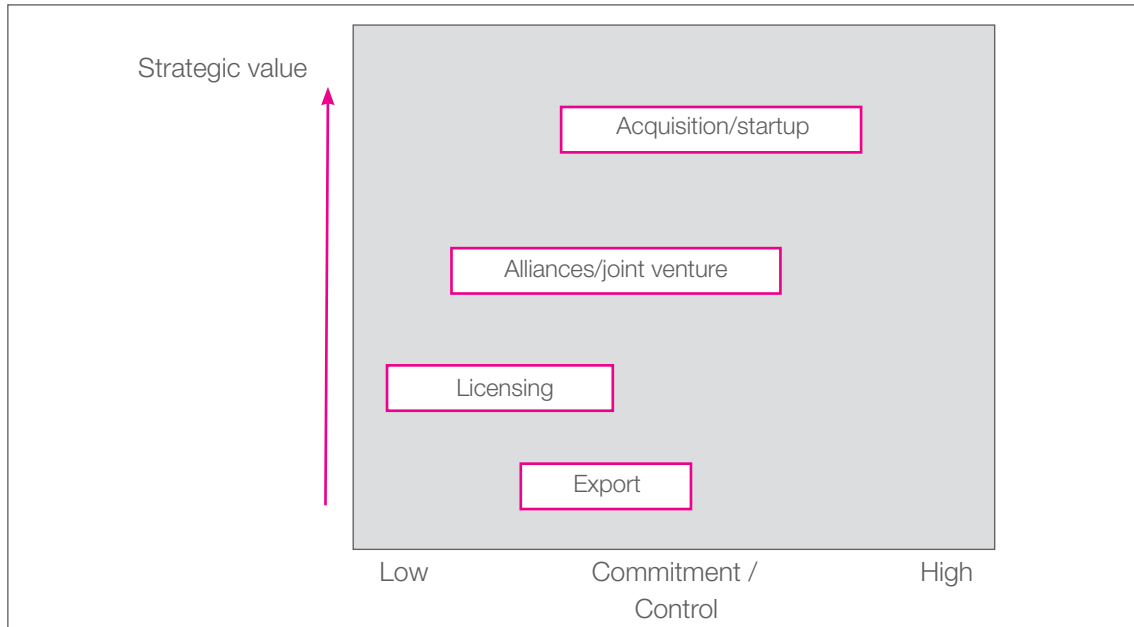
Firm dynamics play an important role in the internationalization process. The outcome will be influenced by the firm's internal decision making, strategy formulation and implementation dynamics. The confrontation of the internal and external analysis can provide the entrepreneur with useful information on the most appropriate strategy for the firm, given the internal and external strengths, limitations, opportunities and threats. Internal resources such as human capital, capabilities, knowledge and technology should be evaluated against factors such as limited financial resources, knowledge of international markets and changes in the international environment.

1.4.1 Entry mode

Choosing the right entry mode is a critical decision to successfully deploy an internationalization strategy. Firms can choose from a range of options, including export (direct or via agents or distributors), licensing, franchising, joint ventures or wholly owned subsidiaries (through foreign direct investment). Some of these options are more suited for SMEs (e.g. exporting, licensing), while the financial needs and risks involved in others (e.g. FDI) may be too high for small firms.

The choice of entry mode is contingent to available resources and commitment. The more abundant the resources and the higher the degree of commitment, the more entry mode options are available to a firm. Under certain conditions (see Table 33 in appendix), high control entry modes are preferred to low control entry modes. Given the limited resource availability, high control entry modes are often not an option for SMEs.

Figure 6 Commitment/control versus strategic value of entry modes



Source: Sleuwaegen (1997)

Different outward modes of internationalization are indirect export, direct export and foreign direct investment (FDI). The most obvious form of FDI is greenfield investment; establishing a new subsidiary abroad. Other forms of FDI are mergers, acquisitions and joint-ventures. Alternative modes of internationalization are strategic alliances or licensing agreements.

The selection of the appropriate entry mode will depend on both internal and external factors. The size, financial and organizational resources of the firm, managerial attitudes and risk taking behavior play a crucial role in this selection process, as do external factors such as country characteristics and market barriers. Entry mode choice will to a great extent determine the success of the internationalization.

Firms can choose from a range of entry modes, including exporting, licensing, concessions, franchising, joint ventures, and partly or wholly owned direct investment. The difference between major entry modes is in the degree of control a firm exerts over its foreign operations (Yip et al., 2000). Small firms with limited financial resources are likely to opt for the relative cost benefits of franchising, concessions, licensing, distributor and agent's agreements (Hutchinson et al., 2005). Direct investment is often not a viable alternative for SMEs, because of financing constraints (De Chiara & Minguzzi, 2002). According to Hutchinson et al. (2005), SMEs are also faced with difficulties when developing a joint venture, as this requires both capital and market power. Franchising requires less financial resources, but will only work if the SME has a well established brand.

McDougall et al. (2003) state there is no single best entry mode for SMEs, and suggest it should be adapted to each country. Firms exporting to multiple countries should use multiple entry modes, based on the specific requirements of the situation and the environment. According to Bell et al.

(2003), traditional firms use conventional entry modes, such as agents or distributors, whereas international new ventures are more likely to use license agreements or alliances.

Rasheed (2005) found that SMEs in fast growing domestic markets experience faster growth when choosing export rather than equity based modes of internationalization. This contrasts with the finding that export negatively influences the financial performance of SMEs (Lu & Beamish, 2001). Brouthers & Nakos (2004) find better performance for SMEs using entry modes based on transaction cost theory. Further, their results indicate that SMEs prefer equity modes of entry when making asset specific investments, and non-equity modes for less asset specific investments. When environmental uncertainty is high, non-equity modes are preferred, to reduce and shift risks to firms in the foreign market. Finally, SMEs with more developed internal control systems seemed to prefer equity based entry modes.

Although choosing the right entry mode is crucial for successful internationalization, only very few SMEs use market research or consult external partners. Papadopoulos & Denis (1988) quote Kothari, who found that 83 percent of SMEs entering foreign markets did so without any research.

1.5 Integrating internationalization in the SME's strategy

Many SMEs lack an explicit strategy, and many more have no internationalization strategy. Most SMEs strictly focus on the local market. Some entrepreneurs do not want to take the risks involved in internationalization, while others are deterred by the barriers SMEs face. Most SMEs however, have never considered internationalization (European Commission, 2004). More entrepreneurs should think about internationalization as a strategic option for their firm and internationalization should be integrated in the firm's strategy.

In the strategy development process, the confrontation of a firm's SWOT with its current situation and mission should lead to a set of strategic options. The choice of the right option will depend on the firm's internal capabilities, its external environment, the conditions in the domestic and the international market, and its ambitions. Firms may have different motives to internationalize, such as gaining access to new customers or to production factors; developing and leveraging core competencies and managing corporate risk.

Establishing an international strategy entails choosing an appropriate competitive strategy, with the right scope and the right balance between the degree of global/local orientation. Different options for regional configuration need to be assessed, based on conditions such as market access, risk management and customer demand characteristics. The success of this strategy will depend on factors such as the market conditions, the product life cycle, the entry mode and the timing.

Next to timing, firms should consider the pace at which they deploy their international activities. On the one hand, firms can choose a so called sprinkler strategy, targeting multiple countries at once. Another option is a waterfall strategy, slowly cascading from one country to the next. Few firms can internationalize simultaneously in all regions. Especially for SMEs, a global attack is not always an option. SMEs are more likely to gradually move from a successful domestic launch towards entering

more advanced countries and in a final stage to less developed economies. A waterfall strategy is optimal if product life cycles are long, and innovation and growth rates in foreign markets are low. If the industry is characterized by short product life cycles, rapid innovation and high growth, firms should opt for a sprinkler strategy.

The internationalization process of SMEs differs from the internationalization of larger firms, because of resource limitations, the liability of foreignness and newness and the importance of the owner/manager. In addition, SMEs not only face more and different barriers than large firms, but these barriers are often harder to overcome, given the resource limitations and the limited financing options available to internationalizing SMEs. Furthermore, SMEs have fewer options in terms of entry mode decisions.

Theoretical developments on SME internationalization resulted in behavioral models, explaining why and how SMEs internationalize. These models, such as **stage models**, **international new venture theory** and **network theory**, describe different paths SMEs may follow in their internationalization process. These models are complementary. There is not one optimal formula that fits all SMEs. The way to internationalize depends on factors such as market conditions, the firm's internal resources and capabilities and the product life cycle.

The value of these models has been demonstrated by empirical research. SMEs use different ways to internationalize, and often do so successfully. Some SMEs use a cautious approach in consecutive **stages**, from export to more integrated modes of internationalization, and from geographically and culturally close markets to more distant countries. Other SMEs, often operating in small high technology niches, opt for a rapid internationalization. These so called "born globals" fit the **international new venture theory**. A third successful approach for SMEs is using **networks** and sharing knowledge and resources with partners, to overcome the obstacles and size constraints smaller firms face when internationalizing. Firms may combine elements of these three models in their internationalization strategy. The next chapter will discuss these models in more detail.

Traditional theories describing international trade are based on the exchange of goods between countries on the basis of comparative advantage. This comparative advantage is derived from differences in opportunity costs of production. The so called “Ricardian” comparative advantage occurs because of productivity differences. The “Heckscher-Ohlin” comparative advantage, on the other hand, arises from a combination of cross-industry differences in factor intensity and cross-country differences in factor endowments.

More recently, theoretical and empirical research in international trade has increasingly focused on firms and products in addition to the traditional focus on countries and industries. However, the bulk of **these studies deal with the internationalization of large multinational enterprises**. Although numerous theories, such as FDI theories and transaction cost theories have been developed, it has been argued that these theories **cannot adequately explain the internationalization of small and medium sized enterprises**. Many theories, such as Dunning’s framework¹, primarily consider FDI activities of multinational enterprises (MNEs). As many small firms do not progress to this stage of internationalization, these theories cannot explain the internationalization behavior of SMEs.

The specific characteristics of SMEs are not taken into account in most internationalization theories. While constrained by limited resources, smaller firms face intense competition in foreign markets, both from incumbent domestic players and large MNEs. Traditional strategies of internationalization that work for MNEs may be ineffective for SMEs. Therefore, SMEs need to develop their own unique competitive strategy when faced with competition from larger firms. To successfully compete in international markets, SMEs need to focus on specific, well defined market niches, in which they hold a competitive advantage, and thus can deliver higher value to their customers.

Over the past decades, the internationalization of SMEs has gained attention from scholars, leading to the development of specific theories explaining the internationalization of SMEs.

2.1 Theories of SME internationalization

No single established model can adequately explain the success of small firm internationalization. However, firms can combine elements from different theories in their internationalization process. Firms can develop firm specific advantages in foreign markets, while following a logical sequence over time and relying on relationships with foreign partners. Thus, the internationalization behavior of SMEs should be viewed as a holistic process, drawing on insights from various theoretical models, including neoclassical theories, stage models and network theories.

¹ Dunning’s (2001) eclectic paradigm integrates different internationalization theories, such as transaction cost theory and Hymer’s (1960) market imperfection theory. According to Dunning’s framework, the extent and pattern of international production is determined by the interaction of three sets of variables: ownership-specific advantages, locational advantages and internalization advantages.

The next section will discuss three prominent theoretical approaches dealing with the internationalization process of SMEs: the stage models, international new venture theories and network theories.

2.1.1 The process or stage theory of small firm internationalization

The stage models describe internationalization as a systematic growth process in incremental stages. As firms learn from their initial international involvement, they gain experience over time and commit more resources to international activities. As firms develop international expertise and skills, they accept the higher risk involved in entering and operating in new and distant markets.

For most firms, the first step in the internationalization process is export. This entry mode enables firms to access foreign markets with limited risk and without large capital investment compared to other entry modes such as foreign direct investment (FDI). This makes export an excellent mode of entry for SMEs.

The so called process or stage models state that SME internationalization is part of an incremental process involving different stages. In these models, internationalization is seen as a gradual process, in which a firm increases its commitment in foreign markets as it gains experiential knowledge (Johanson & Vahlne, 1990). This implies that firm size, age and experience have a direct and positive relationship with the extent of internationalization (Etemad, 2004). The most widely known is the **Uppsala model**. From an operational strategy perspective, Johanson & Vahlne (1977) identified four stages of internationalization:

- no regular export activities
- export via agents
- establishment of a sales subsidiary
- production/manufacturing in a foreign market.

Each of these stages involves increased risk and commitment for the firm.

A second well known model, next to the Uppsala model, is the **innovation related internationalization** model (Cavusgil, 1980), in which the internationalization decision is considered an innovation for the firm. This stage theory describes the internationalization process in five stages:

- domestic marketing
- pre-export
- experimental involvement
- active involvement
- committed involvement

The number of stages in different models generally ranges from four to six. Some authors (e.g. Bilkey & Tesar, 1977) include a stage of unsolicited, buyer initiated export. In some models (e.g. Johanson & Vahlne, 1977), the final stage of internationalization involves a resource commitment to foreign markets (i.e. FDI). Others (e.g. Bilkey & Tesar, 1977) see export to more distant countries as the final stage.

Firms generally start exporting to countries that are geographically and socio-culturally closest (Calof, 1991). Most SMEs thus start exporting to neighboring countries. The combination of geographical

proximity, in many cases also cultural similarity and a limited psychic distance reduce the perceived risk of internationalization for SME managers. Gradually, firms expand their geographic scope and start exporting to more distant countries.

Gankema et al. (2000) have tested Cavusgil's innovation-related internationalization model. They found that the international involvement of SMEs does indeed expand over time, thus supporting the stage theory. Although this theory holds in general, some SMEs have skipped some stages and progressed rapidly from one of the first to one of the last stages. Other firms have stopped the internationalization process before reaching the final stage.

2.1.2 Limitations of the stage theories

Over time, the stage theories have received some criticism. Apart from theoretical challenges, the empirical relevance of these models has also been questioned. An increasing number of empirical studies found evidence contradicting the stage models of firm internationalization, as firms skipped stages. A fundamental inconsistency seemed to emerge between stage theories and the empirical reality of an increasing number of firms adopting a global focus from inception.

Although a number of small firms follow the stage pattern, this is not the case for all small firms. A rational, incremental approach to internationalization may not be the most appropriate option for a small firm. There is increasing evidence that these stage theories are no longer relevant. As transportation and communication costs are rapidly declining, some firms operating in global niches can skip certain stages (Oviatt & McDougall, 1994). Reuber & Fisher (2002) suggest that firms with an internationally experienced management team can skip the first two stages. Andersson, et al. (2004) state there is abundant empirical evidence demonstrating that not all firms follow a stepwise, gradual internationalization process, and some firms internationalize quickly and right from the start.

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2.1.3 International New Venture Theories

As the extant internationalization theories, such as the stage models, failed to explain the rapid internationalization of certain firms, a new school of thought emerged with the research of Oviatt & McDougall (1994) on international new ventures (INVs). These firms are international from inception. In a framework that integrates international business, entrepreneurship and strategic management theory, they explain the phenomenon. INVs are characterized by:

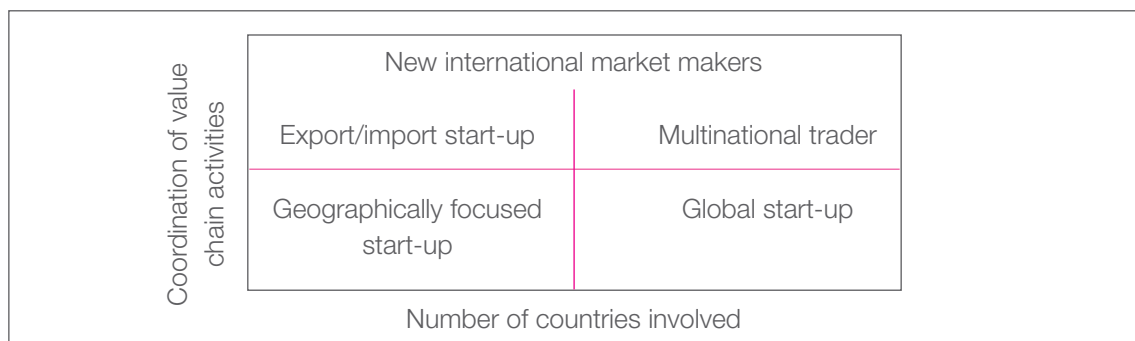
- organizational formation through internalization of some transactions
- strong reliance on alternative governance structures to access resources
- establishment of foreign location advantages
- control over unique resources

Oviatt & McDougall (1994) define an international new venture as *"a business organization that, from inception, seeks to derive significant competitive advantage from the use of resources and the sale of outputs in multiple countries."* These firms use a proactive international strategy and make significant resource commitments to foreign markets, although this does not necessarily require foreign direct investment.

Oviatt & McDougall (1994) describe four different types of international new ventures, according to the number of value chain activities that are coordinated and the number of countries the firm operates in:

- export/import start-ups
- multinational traders
- geographically focused start-ups
- global start-ups

Figure 7 Types of international new ventures²



International new market makers can be either export/import start-ups or multinational traders. These firms create new markets and exploit new opportunities before increased competition reduces margins. They build a competitive advantage on superior knowledge of markets and suppliers and a network of business associates. Export/import start-ups focus on serving a few countries, while multinational traders serve a large number of nations and constantly look for opportunities to expand their network.

Geographically focused start-ups use foreign resources to serve the specialized needs of a particular region. Their competitive advantage is in the coordination of multiple value chain activities.

Global start-ups are the most radical manifestation of the international new venture. These firms respond to global markets by acting on opportunities to acquire resources and selling outputs in those places in the world where the added value is highest. The competitive advantage of these firms is derived from coordinating multiple activities in multiple geographical locations. These international new ventures, once successfully established, have the most sustainable competitive advantage (Oviatt & McDougall, 1994).

According to Oviatt & McDougall (1994), cheap and easy communication technology and transportation allow small firms to take advantage of business opportunities in multiple countries, whereas this used to be the preserve of large, mature corporations. International new ventures can thus be globally competitive, despite their resource constraints. International new ventures are often found in volatile markets, have little or no experience and limited resources. This contradicts Johanson & Vahlne's (1990) stage theory.

² Source: Oviatt & McDougall (1994).

McDougall et al. (2003) investigated the differences between international and domestic new ventures. They found significant differences in the entrepreneurial team experience, strategy and industry structure of international new ventures (INVs) compared to domestic ones. INVs had higher levels of previous international and industry experience in their management team and more aggressive strategies. Differentiation was crucial in the competitive strategy, emphasizing innovation, quality, service and marketing as strategic weapons. The industries INVs operated in had higher degrees of global integration.

The rapid internationalization of some small firms has been driven by increasing homogenization of foreign markets, increasing international business experience of entrepreneurs, availability of international financing opportunities and international mobility of human capital. Firms possessing unique assets may skip stages of international development, and for some firms internationalization may not be an incremental process at all. These firms set up their activity targeting either a market that is global by nature or a niche with limited potential on the domestic market. Oviatt & McDougall (1994) thus argue that stage theories are less applicable in some situations, i.e. where technology, firm capabilities and the industry environment have changed radically. However, they may still apply to other firms and industries.

The stage theory and new venture theory have different underlying assumptions. **While stage theory assumes *survival* to be the fundamental goal of the firm, new venture theory sees *growth* as the primary driver for internationalization** (Sapienza et al., 2006). According to stage theory, firms wait to expand internationally until they are either pushed by external circumstances or pulled by customer demands. In new venture theory, firms may see internationalization as a strategic choice and an option for growth.

In high technology sectors, rapid internationalization is essential for firm survival, as firms need to reach high sales volumes before technologies become obsolete or get imitated by other firms. Although much of the (initial) research on international new ventures focused on high technology sectors, the phenomenon has also been found in older, mature sectors (Andersson et al., 2004). Madsen & Servais (1997) found that international new ventures from large countries are mainly active in high technology industries, while international new ventures in smaller countries are most often found in other sectors. Andersson et al. (2004) found no positive relation between international activities in small firms and the technology level of firms.

Moen & Servais (2002) investigated whether the phenomenon of international new ventures is really a change in the export behavior of firms, or just a reduced time factor in the pre-export phase of the stage model. Their results indicated that both the Uppsala and the innovation related stage model cannot explain the export behavior of their sample of both new and older, established SMEs. Their results further suggest that export intensity, distribution, market selection, and global orientation are not linked to firm age or age at the start of export activities. Those firms that started exporting within two years after inception (one third of their sample), reported higher export intensity than those firms that waited longer.

Despite the growing evidence of international new ventures, most new ventures remain national. New firms face higher barriers to enter foreign markets than larger, established firms (Acs, 2005). Therefore, the entrepreneur has a critical role to play in the decision to internationalize. International

entrepreneurship is characterized by the creation and exchange of value through identifying and exploiting opportunities that cross national borders. Internationalization has many of the characteristics associated with entrepreneurship, such as risk taking in uncertain environments, adopting innovative behaviors, exploiting opportunities by entering new markets, and involving entrepreneurial managers. McDougall & Oviatt (2000) define international entrepreneurship as: “a combination of innovative, pro-active, and risk seeking behavior that crosses national borders and is intended to create value in organizations”.

Although Jones & Coviello (2005)³ suggest different entry modes can be used in international entrepreneurship, the most prevalent mode of internationalization among new ventures is export (Zahra et al., 2000).

Early internationalizing firms are confronted with a *liability of newness*. Young firms lack experience and may not have developed the routines and relationships needed to survive. Late internationalization allows firms to assemble resources and gain experience before entering markets abroad. However, it can also allow inertia to develop (Sapienza et al., 2006). The stage models claim that early internationalization can have a negative impact on firm survival. On the other hand, examples of early internationalization, especially in dynamic and high technology sectors, show positive effects of early internationalization. For these firms, doing business in foreign markets is a catalyst for growth, and late internationalization implies lost opportunities. Sapienza et al. (2006) argue that early internationalization increases a firm’s dynamic capabilities for exploiting opportunities in foreign markets. Autio et al. (2000) suggest *learning advantages of newness* allow early internationalizing firms to grow more rapidly than older entrants. The authors state that these learning advantages can offset liabilities of newness. However, Sapienza et al. (2006) argue that, while early internationalization can indeed increase growth prospects, it may at the same time reduce the probability of survival. Although internationalization eventually creates new capabilities, it also requires a large resource investment, thus reducing short term chances of firm survival.

2.1.4 Network models

SMEs need to leverage their specific capabilities and distinctive competences to ensure successful internationalization. An effective way to do so is by establishing and managing relations with partners at home and abroad (Etemad, 2004). SMEs often have insufficient knowledge and resources to overcome the barriers associated with internationalization. As a result, many SMEs that internationalize need to rely on a network of partners, in which resources and knowledge can be shared.

Network theories assume that firms share complementary competitive advantages with other firms to drive international growth. Firms with complementary competitive advantages can leverage their own firm specific advantages to benefit not only the firm itself, but also the partnership. This form of collaboration enables a firm to quickly position itself in foreign markets, drawing on the expertise and the complementary strengths of other, local firms. Although firms lose independence compared to FDI, less time and resources are required and risk is reduced.

³ Jones and Coviello define international entrepreneurship as “a rapid process of international expansion from inception, using a range of market entry modes in multiple markets”.

Managing these relations relies on entrepreneurial traits, rather than on physical resources. SMEs can build their internationalization strategy around these networks and locally based capabilities and competences.

Competitors cannot easily imitate these strategies, as similar networks are difficult to develop. Etemad et al. (2001) have demonstrated that most of such collaborative relationships turn synergistic, i.e. they are complementary and mutually enhancing for all partners.

2.1.5 A holistic approach

Based on the stage theories and the international new venture theory, one could assume that some SMEs internationalize progressively, following a cautious process, while others follow a path of rapid, early stage internationalization. However, it has been argued that this distinction may be too rigid (European Commission, 2004). An SME can use a mix of different models in its internationalization process. A firm's international activities may also be mutually supporting each other. Moreover, different forms of internationalization serve different strategic goals, rather than stages in a gradual process. Especially when searching for know-how or technology, firms may set up an alliance with a foreign firm straight away, without passing a stage of direct export. In such cases, a combination of different forms of international activities may be more appropriate than successive stages in a gradual process. Therefore, the internationalization process should be viewed as a holistic process. In such a holistic approach, different forms of international activities could be seen as a comprehensive set of strategic options.

Firms entering foreign markets need to step away from existing routines and create new ones. This requires substantial investment, both in terms of time and financial resources. Firms need to establish new relationships and may need to hire additional personnel. These investments may initially decrease prospects of firm survival. However, internationalization opens up new opportunities for growth (Sapienza et al., 2006). By exposing firms to foreign markets, with higher risk and uncertainty, internationalization forces firms to adapt their routines and create new capabilities. Leveraging these capabilities to expand firm activities and approach new markets can drive long term growth. Entering foreign markets connects firms with competitors, customers, suppliers and innovations outside their domestic market, which enables them to identify new opportunities. Firms leveraging their capabilities across markets, cannot only expand their operations and revenues, but also reinforce their core business in the domestic market (Sapienza et al., 2006).

Export has important benefits at both the macro and the micro level. The impact of export on sales growth is straightforward. In addition, the subsequent larger sales volumes enable firms to achieve economies of scale and to increase labor productivity and management efficiency. The associated cost savings have a direct impact on firm profitability. Other benefits of exporting include an increase in market power and a diversification of revenues, which in turn may affect profitability. A growing body of empirical research has demonstrated the superior characteristics of exporting firms relative to domestic firms. Exporters are larger, more productive, more capital-intensive, more technology-intensive, and pay higher wages (Bernard & Jensen, 1999). The central issue is the direction of the causality between export and firm performance.

Export is often linked to firm success. When facing competition in international markets, firms must improve their performance to remain competitive. Therefore, exporting firms are assumed to have higher levels of productivity, sales and employment than domestic firms. Another assumption is that in order to export, firms first need to improve their performance to cover the additional costs associated with internationalization and the increased competition.

In a review of empirical studies on export and productivity, Wagner (2005) found that exporters consistently outperformed non-exporters. In 41 studies in more than 20 different countries, higher levels and/or growth rates of productivity (labor productivity, total factor productivity, or both) were found. Most of these studies addressed the issue whether these differences already existed before foreign market entry, or whether exporting made these firms more productive. Looking at post-entry differences, the evidence is mixed. Although most (22) of the studies reporting post-entry data find positive post entry effects, a smaller number of studies (13) find negative or insignificant differences. However, in some countries, such as the UK and Taiwan, all studies seem to find positive post-entry difference. Wagner thus concludes that the more productive firms self-select into export markets, while exporting does not necessarily improve productivity (Wagner, 2005).

Bernard & Jensen (1999) explore whether good firms become exporters and whether exporters outperform non-exporters. In their study of US manufacturing firms, they find evidence that good firms become exporters. Exporting firms already have higher growth rates and levels of success measures years before they start exporting. However, the benefits of exporting for the firm are less convincing. Although exporting firms experience higher employment growth and have a higher

probability of survival, productivity and wage growth are not higher, particularly in the long run. In general, exporting firms are larger than non-exporters. Bernard & Jensen (1999) find that in their sample, total employment and total shipments are twice as large for exporters. Even for SMEs (fewer than 250 employees), exporters are found to be 50%–66% larger than non-exporters. Furthermore, a 10% increase in employment will increase the likelihood of exporting by 1%.

In terms of performance prior to entry, Bernard & Jensen (1999) find that firms that become exporters are 20%–45% larger in terms of employment, 27%–54% larger in terms of shipments, have higher labor productivity (7%–8%), pay higher wages (2%–4%) and experience higher employment growth. These characteristics are found in these firms in the years before their first exporting activities.

A more important issue, from a firm perspective, is whether exporting improves performance. Bernard & Jensen (1999) suggest that while export does not lead to faster productivity growth at the firm level, employment growth is higher. Probably the most important advantage of export, both at the macro and micro level, is firm survival. Exporting firms are 10% more likely to survive than non-exporters with similar characteristics.

In a sample of Japanese SMEs, Lu & Beamish (2001) analyzed the impact of different modes of internationalization on performance, measured by return on assets (ROA). They found that FDI activities have the highest positive impact on performance. However, they note that SMEs' resource limitations may inhibit them from overcoming the high costs involved in FDI for newly internationalizing firms. Lu & Beamish (2006) extend their research by adding return on sales (ROS) and growth (of sales and assets) as measures of performance. They find a positive impact of both export and FDI on growth. The relationship with profitability is more complex: export has a negative impact on profitability, while FDI has a U-shaped curve relationship with profitability. In a study of US SMEs, Rasheed (2005) found a positive impact of export on performance for SMEs in fast growing sectors. The results further indicate that firms using equity based internationalization modes have higher growth than exporting firms, when foreign risk is higher.

In a recent study of Belgian manufacturing industries, Coucke & Sleuwaegen (2007) find that import from low-wage countries lowers a firm's chances of survival. However, those firms that take advantage of opportunities provided by globalization can improve their chances of survival. Firms with international outsourcing activities can benefit from differences in international factor prices. Outsourcing to firms outside the EU has a larger impact than sourcing from parties within the EU. Firms upgrading their domestic activities by benefiting from global sourcing not only increase their chances of survival, but can also be expected to create jobs. Nonetheless, only 28 percent of domestic firms engaged in international outsourcing. The results further suggest that firms confronted with fierce global competition have to increase efficiency and consequently will become exporters, and not the other way around.

Coucke & Sleuwaegen (2007) conclude that *"the best defense against the negative effects of globalization appears to lie in adopting offensive strategies and exploiting new possibilities in globalizing industries."*

The impact of trade on firm survival is confirmed by Muûls & Pisu (2007), using firm level data across industries in Belgium. While only 57% of non-traders survived between 1996 and 2004, up to 74%

of two-way traders survived. Of those firms with only import or export, respectively 64% and 62% survived. However, in terms of the number of jobs lost, the picture is quite different. The number of jobs in non-traders increased by 2% between 1996 and 2004. Importers and exporters did much better, with increases of 70% and 105% respectively. Employment in two-way traders on the other hand dropped by 13%. Muûls & Pisu (2007) further found that the impact of import on productivity is larger than that of export. Labor productivity of importers is 15% superior to non-traders, while exporters' productivity was only 6% higher. The most productive firms are two-way traders, with productivity advantages of 27% compared to non-traders.

Both export and import increase chances of firm survival.

The previous chapters focused on various theoretical aspects of SME internationalization. In the next chapters, these theoretical findings will be confronted with empirical data, both from Belgian and European sources. This section will specifically focus on data from a European survey (European Commission, 2004) on SME internationalization. In this survey, a sample of 7,745 European SMEs from 19 different countries were interviewed. This survey provides interesting data for comparison across countries. However, the disproportionate sample that has been used, both in terms of sectors and size class, implies that data may not be representative for the total population.

4.1 Mode of internationalization

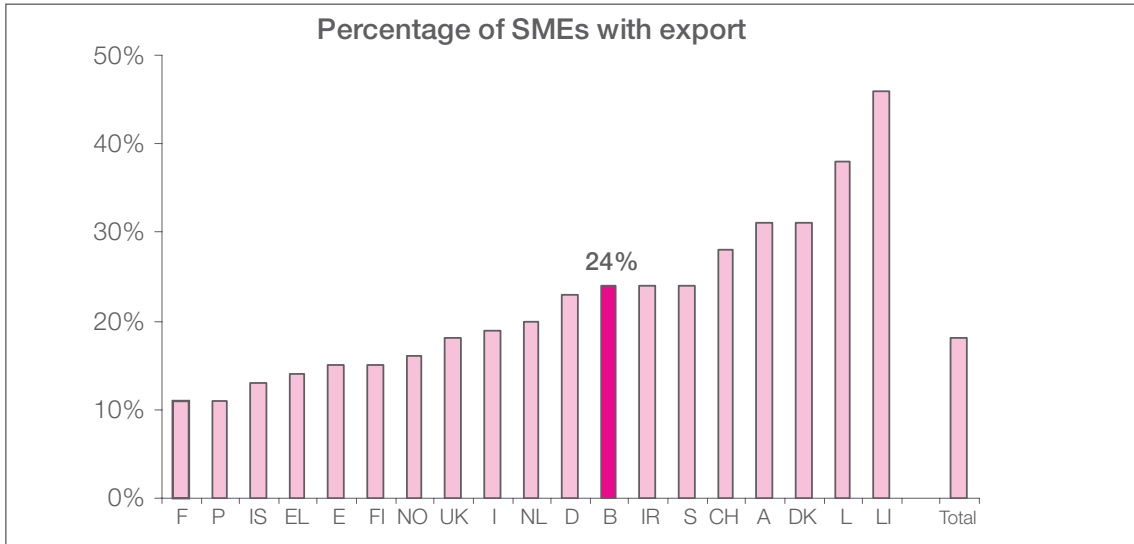
For the 19 surveyed countries, on average 18% of SMEs export. The highest number of exporters are found in Lithuania (46%) and Luxembourg (38%). France and Portugal (both 11%) have the lowest percentage of exporting SMEs. In Belgium, one in four SMEs is exporting. This is above average, but less than some countries similar in size, such as Switzerland, Austria and Denmark. As manufacturing firms are more predisposed to exporting, a country's sector structure has a significant impact on the number of exporting firms. Hessels & Stigter (2004) found that up to 30% of Dutch SMEs in manufacturing export, while in services only 8% export. In the same sample of Dutch SMEs, only 10% of those firms with less than 10 employees export, while 25% of SMEs with 10 up to 99 employees export. The number of SMEs with import and foreign direct investment also increases with firm size.

The most common mode of SME internationalization is import. On average, for 19 European countries, 30% of SMEs import, while 18% are involved in export activities. Belgian SMEs are more internationally oriented than their European counterparts: 45% of Belgian SMEs import and 24% export. Four percent of Belgian SMEs invested abroad. This is more than the average (3%) for these 19 European countries, but significantly less than countries such as Iceland (11%) and Denmark (9%). In some countries like South Korea, up to 38 percent of SMEs have foreign investment (OECD, 2007).

In the US, the number of exporting firms is lower than in European countries. Bernard et al. (2007) state that of the 5.5 million US firms, including large enterprises, only 4% are exporters. In those industries more inclined to export, such as manufacturing, up to 15% were exporting. Across sectors, the top 10 percent of these exporting firms accounted for 96 percent of total US exports. Bernard & Jensen (1999) found that within the group of exporters, more than 15% will stop exporting each year, while about 10% of non-exporting firms will enter a foreign market.

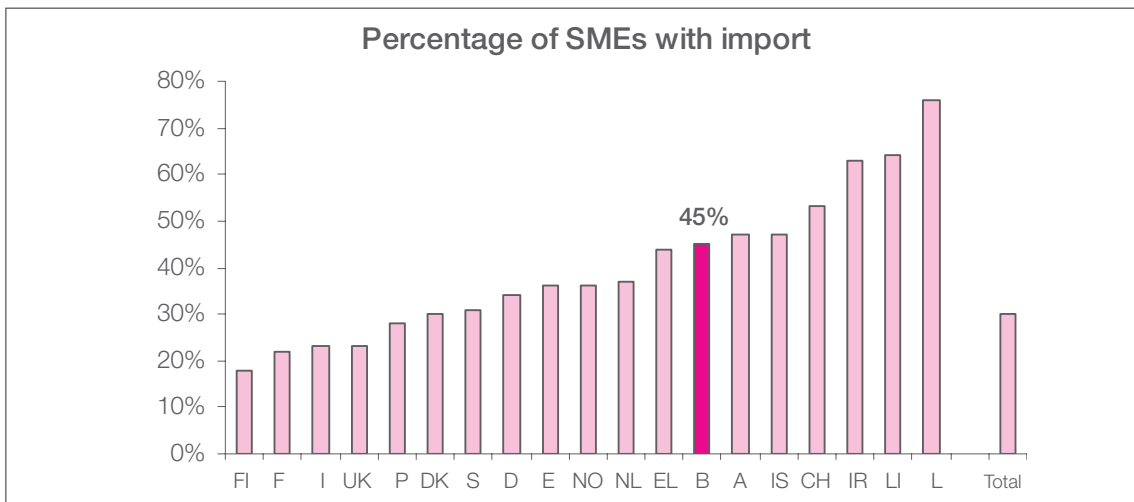
The number of importing SMEs is much higher than those that export. On average, 30% of SMEs have a foreign supplier, with percentages ranging from 18% in Finland up to 76% in Luxembourg. In Belgium, 45% of SMEs import. Similar to export, the percentage of importing firms is above average.

Figure 8 Percentage of exporting SMEs in Europe



Source: European Commission (2004)

Figure 9 Percentage of importing SMEs in Europe

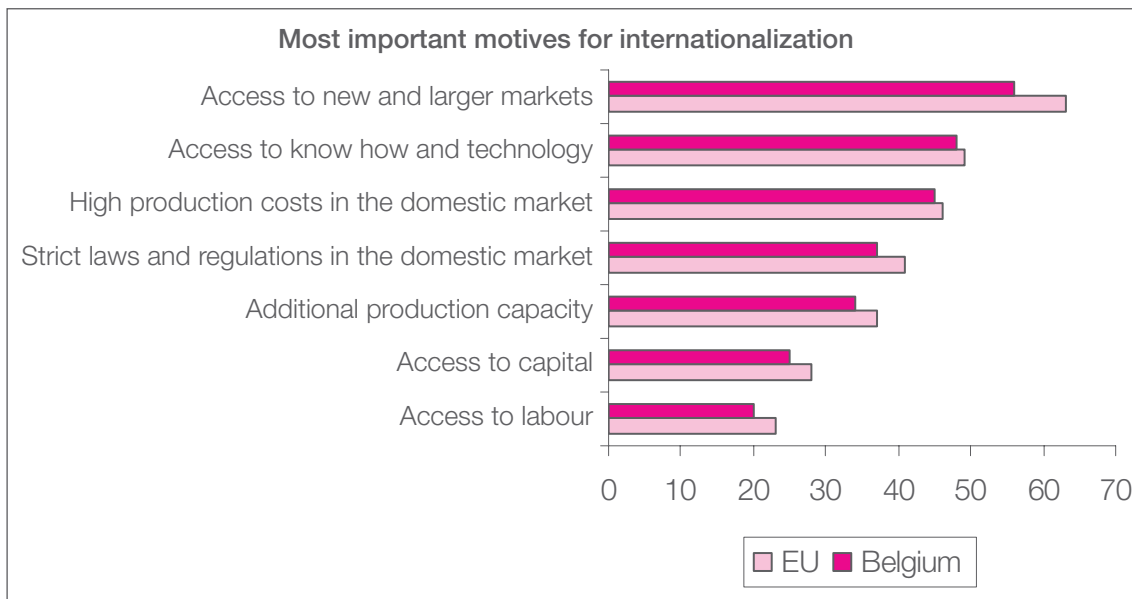


Source: European Commission (2004)

4.2 Drivers of internationalization

For most SMEs in Europe, the main reason to start exporting is gaining access to new and larger markets. Up to 63% of SMEs state this is an important or very important reason for internationalization. A second important motive is the know-how and technology in foreign markets (49%), and the high production cost in the domestic market is the third most important driver (46%).

Figure 10 Most important motives for internationalization, SMEs in Europe and Belgium

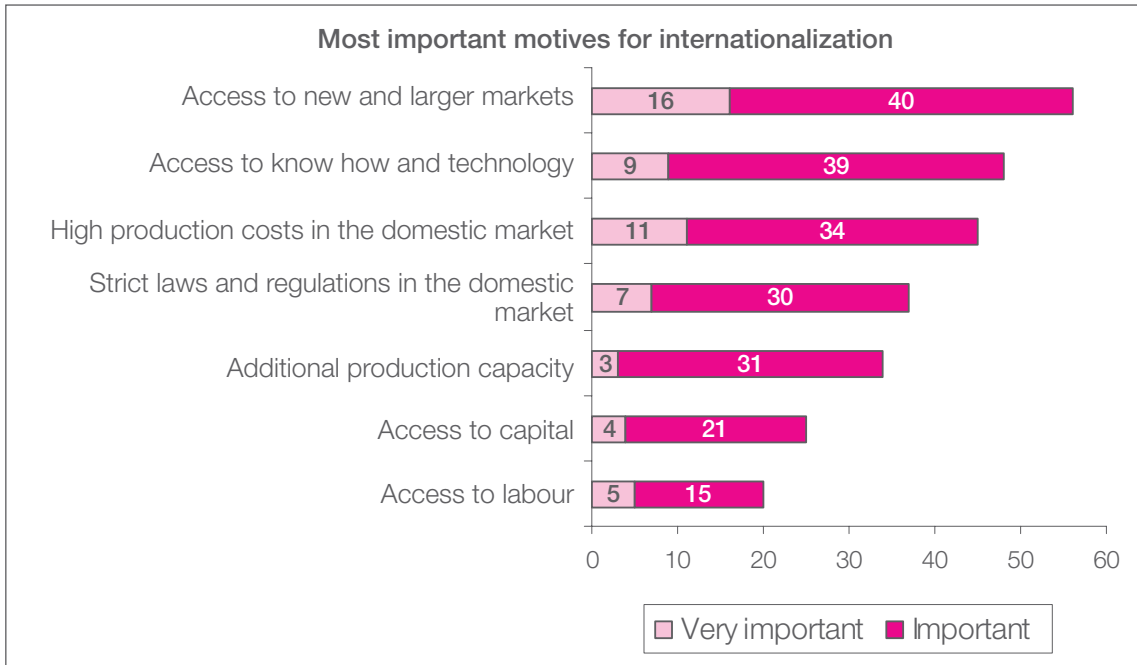


Source: European Commission (2004)

There is no difference in order of importance of these motives between SMEs in Belgium and the average European SMEs, although the percentage of Belgian SMEs indicating these factors are important, is lower for each of these motives, compared to the European average.

The most important motive for internationalization for Belgian SMEs (56%) is access to new and larger markets. Next to this **market seeking** driver, a second (48%) important motive is **strategic asset seeking**, as SMEs look for access to know-how and technology in foreign markets. A large number of SMEs (45%) have resource seeking motives for internationalization, as they indicate that the high production costs in the domestic market are an incentive to internationalize. 44% of Belgian SMEs state that internationalization improved their competitive strength. Access to capital and labor (**resource seeking**) are least often mentioned by Belgian SMEs as drivers for internationalization.

Figure 11 Most important motives for internationalization for SMEs in Belgium



Source: European Commission (2004)

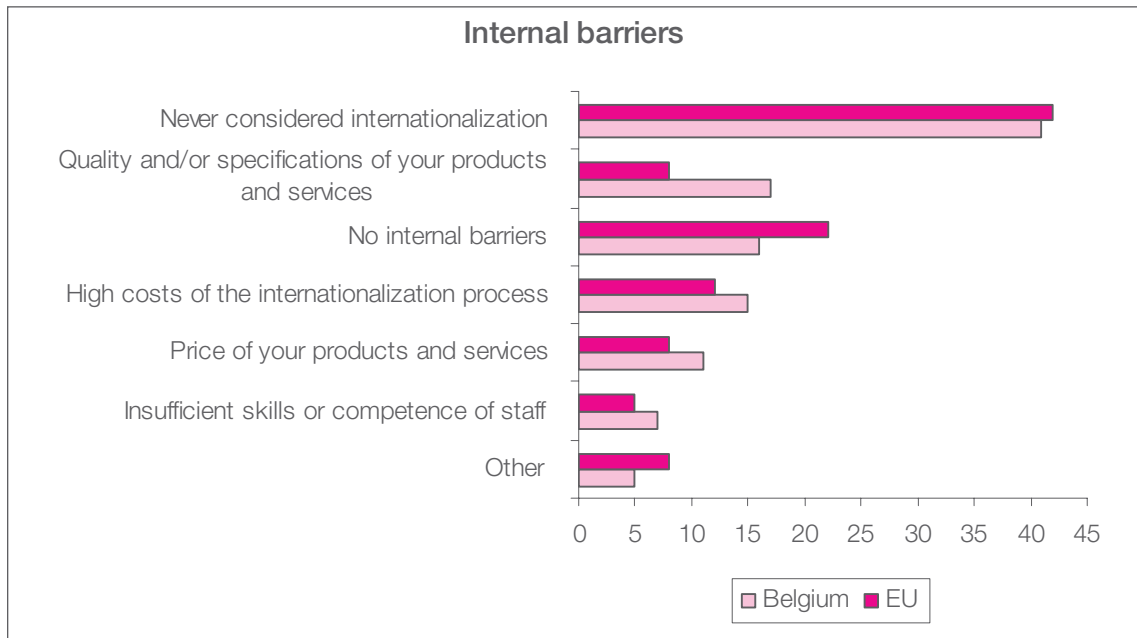
4.3 Barriers for internationalization

Almost 60 per cent of non-internationalized SMEs in the ENSR sample have never considered internationalization as a business opportunity. On the other hand, more than 15 per cent of the non-internationalized SMEs perceive no internal barriers, and about the same number has no external barriers to internationalization. For the remaining SMEs, the observed barriers are the same for internationalized and non-internationalized SMEs.

Internal barriers

Across countries, the most often cited internal barrier is the high cost of the internationalization process. For SMEs in Belgium, the most important internal barrier (17%) for internationalization is the quality of the products, while this appears to be of less importance to other European SMEs. 15% of Belgian SMEs see the high costs involved in internationalization as an important obstruction, and 16% have no internal barriers. This is consistent with the results from an OECD survey, indicating that the major barriers for SME internationalization relate to internal capabilities, rather than the business environment (OECD, 2006). However, non-exporters rate financial barriers higher, whereas exporters are more concerned with issues related to the business environment, including trade barriers.

Figure 12 Internal export barriers for SMEs in Europe and Belgium

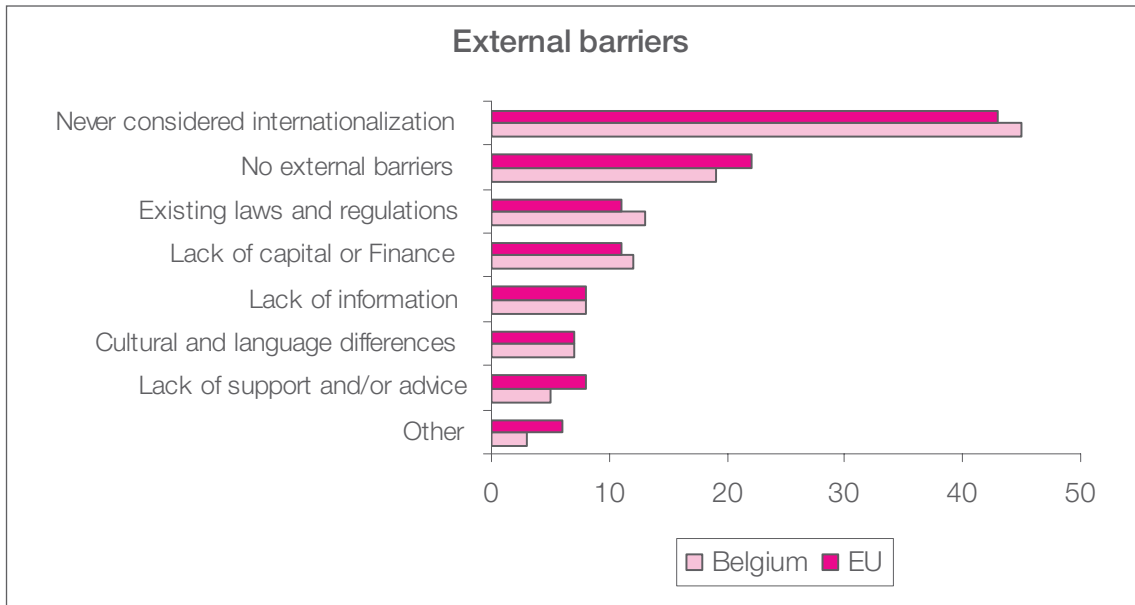


Source: European Commission (2004)

External barriers

While 19% of Belgian SMEs have no external barriers, the most often mentioned problems are laws and regulations (13%) and lack of capital (12%). A small number of SMEs say they have insufficient information (8%), or lack support and advice (5%). Gielens et al. (1998) found that geographic distance remains an important barrier to export, even within a unified Europe.

Figure 13 External export barriers for SMEs in Europe and Belgium

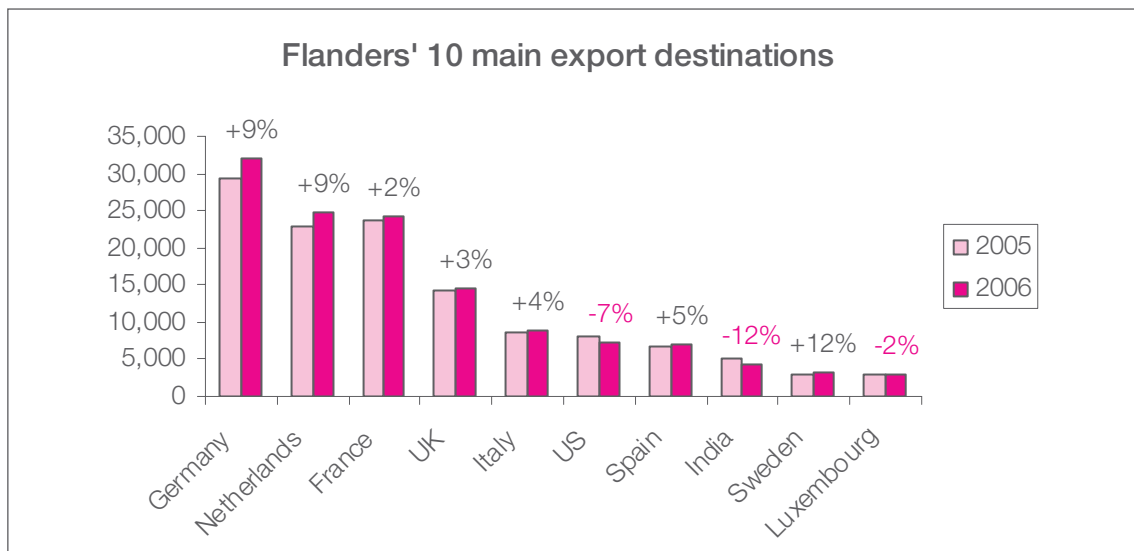


Source: European Commission (2004)

5.1 Macro economic context

Belgium has an open economy, with high levels of import and export. Total Belgian export increased by 6% in 2006, to reach a record of €223 billion. Total import was €220 billion, a 7% increase over 2005. Most trade is within the EU, representing 77% of total Belgian export and 75% of import. In 2006, Flanders accounted for 80% of Belgium's export⁴. The value of export originating from Flanders reached €178 billion, a 5.6% increase over 2005. The EU is the main export destination, with 75% of export or €134 billion shipped from Flanders to the 26 other EU members. Germany, the Netherlands and France are the main trade partners, comprising 45% of export from Flanders. Of the 10 main export destinations, only 2 are non-EU countries: the US (6th) and India (8th), although export to these countries dropped by 7% and 12% respectively, compared to 2005.

Figure 14 Ten main export destinations for Flanders (million euros)



Source: Flanders Investment and Trade (2007)

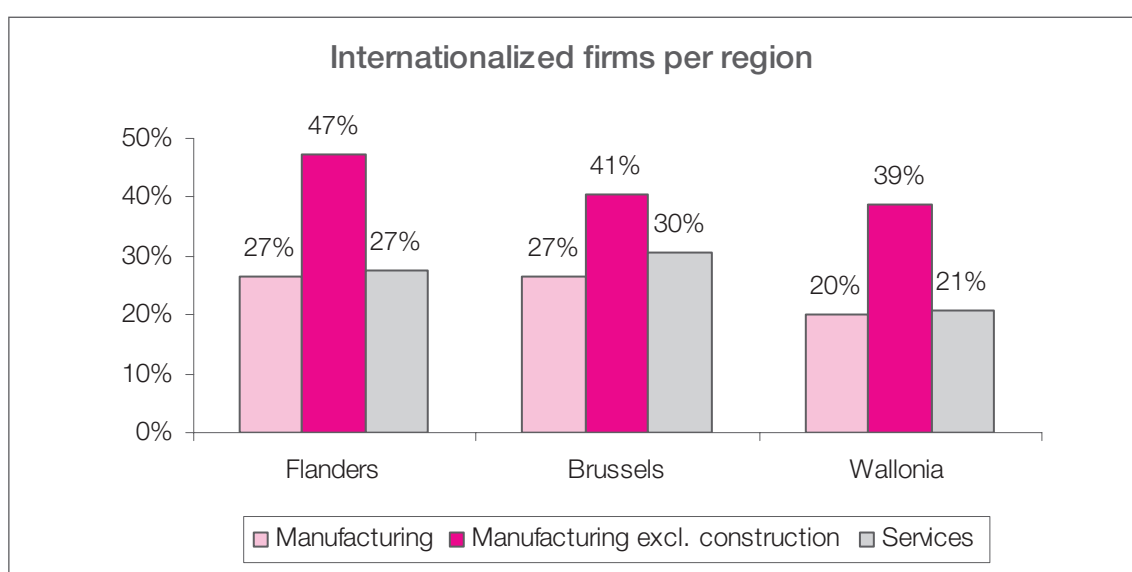
Except for India, these 10 countries match the 10 most important countries for Belgian SMEs to do business abroad, according to the ENSR Enterprise Survey (European Commission, 2004).

⁴ Source: Flanders Investment and Trade (2007).

5.2 Data on internationalization of SMEs in Belgium

Of the total population of 94,971 Belgian SMEs with at least one full time equivalent (FTE) employee, most firms (78%) are micro enterprises, 19% are small firms and 2% are medium sized firms. Overall, 24,549 or 26% of these SMEs were internationally active in 2002, either through import, export or both. This proportion is roughly the same for manufacturing (24.9%) and services (26.3%). However, leaving out construction, 44.6% of manufacturing SMEs are internationalized.

Figure 15 Percentage of internationalized firms in Flanders, Wallonia and Brussels (2002)



Source: VIO database

In Flanders and Brussels, an equally high share of manufacturing firms (26.6%) is internationalized. In Wallonia, only 20% of manufacturing firms are international. Leaving out construction, the share of internationalized firms is highest in Flanders (47.2%), and the gap between Brussels (40.6%) and Wallonia (38.9%) is substantially reduced. Brussels has the highest share of services firms with international activities (30.5%), followed by Flanders (27.4%) and Wallonia (20.7%).

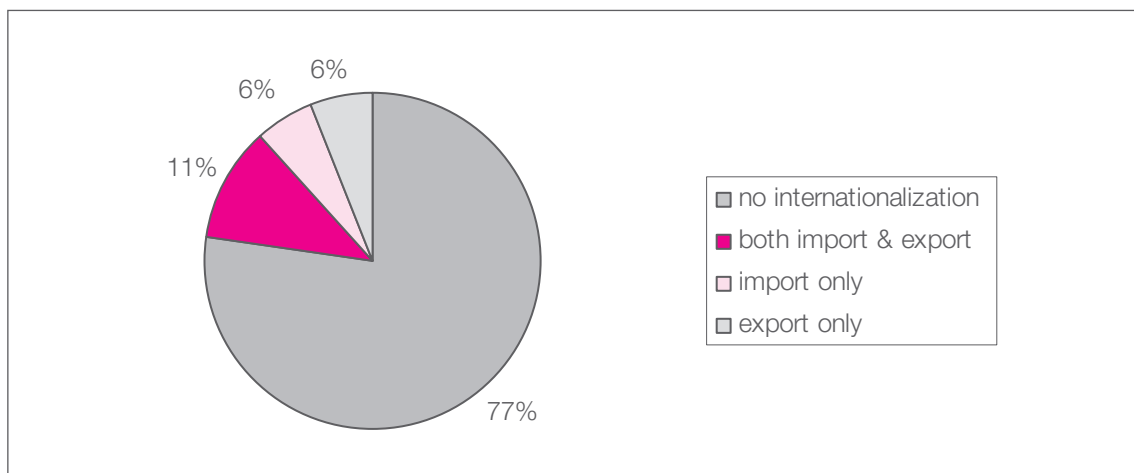
5.3 Manufacturing

In this section, the internationalization of all Belgian (domestic owned) manufacturing (NACE 10-45) SMEs (less than 250 employees and turnover less than €50 million) with at least 1 FTE will be analyzed. This broad definition of manufacturing includes mining (NACE 10-14), utilities (40 and 41) and construction (45). These sectors are not included in a more conventional definition of manufacturing, which comprises only NACE 15-37. These latter sectors will be referred to as “core” manufacturing sectors.

5.3.1 Mode and geographical scope of internationalization

Of the 28,284 Belgian manufacturing SMEs, 77% had no international activities in 2002, leaving 23% with one or more forms of internationalization. The most common mode of internationalization was the combination of import and export (3,133 firms or 48% of internationalized SMEs). Of these firms that both import and export, 1,284 had both intra-EU and extra-EU import and export, and another 1,338 firms traded (either import or export) with partners both inside and outside the EU⁵.

Figure 16 Mode of internationalization of Belgian SMEs in manufacturing (2002)



Source: VIO database

About one in four internationalized SMEs import only, and roughly the same share only export. While import from the EU is more common than extra-EU import, a larger proportion of firms export to destinations outside than inside the EU.

Table 1 Mode of internationalization of Belgian SMEs in manufacturing (2002)

		intra-EU	extra-EU	both
no internationalization	21,814			
both import & export	3,133	293	218	2,622
import only	1,637	822	315	500
export only	1,700	614	728	358

Source: VIO database

SMEs are often involved in more than one form of internationalization. More than 50% of importing firms also export. Up to 73% of firms that import from outside the EU also import from within the EU. About 60% of exporters also import. Table 2 shows for each row the percentage of firms engaged in other international activities.

⁵ EU refers to the EU-15, the relevant union for the period covered.

Table 2 Percentage of exporting and importing manufacturing SMEs with other international activities (2002)

	import		export	
	intra-EU	extra-EU	intra-EU	extra-EU
intra-EU import	100.0	62.3	52.5	52.1
extra-EU import	73.4	100.0	56.8	65.1
intra-EU export	60.8	55.9	100.0	63.0
extra-EU export	56.5	60.0	59.0	100.0

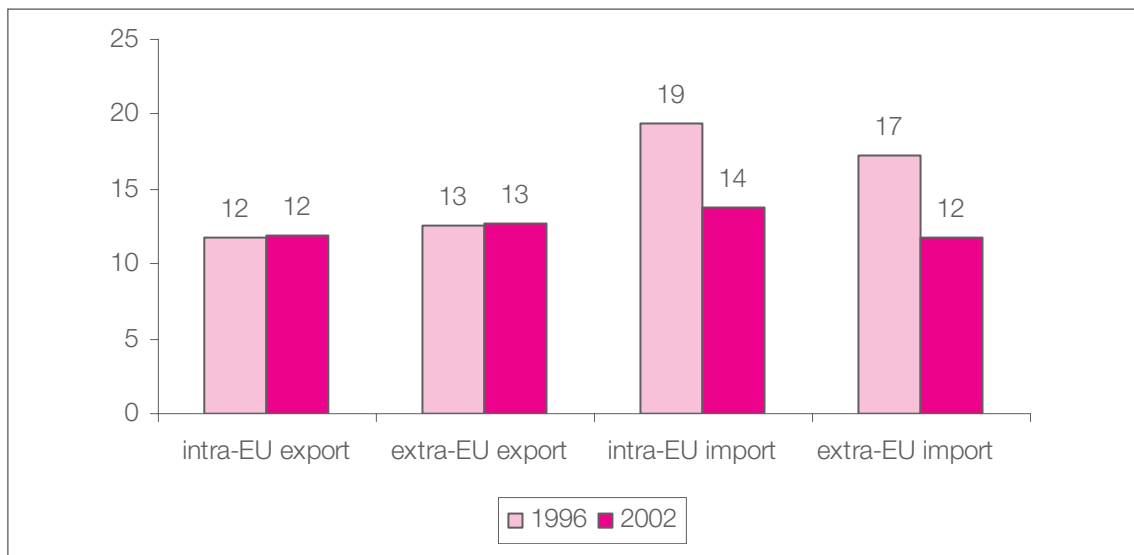
Source: VIO database

Evolution in geographical scope of internationalization

In 2002, about 12% of manufacturing firms had intra-EU export and 13% exported to countries outside the EU. This percentage is stable compared to 1996. In contrast, the percentage of importing firms dropped from 19% in 1996 to 12% in 2002 for intra-EU import and from 17% to 13% for extra-EU import.

I 54

Figure 17 Evolution in geographical scope in internationalization of Belgian manufacturing SMEs (1996-2002)



Source: VIO database

Export and import by sector

On average, 17% of manufacturing SMEs export. However, since the number of exporters is sector dependent, large differences exist across sectors. In some small sectors, such as tobacco (16), almost all firms export. For none of the core manufacturing sectors (15-37), the number of exporters

is smaller than 20%. On the other hand, in construction (45) only 4% of firms export. As this is by far the largest manufacturing sector, this heavily distorts the global picture. Leaving out the construction industry, the share of exporters is 32%.

Table 3 Percentage of exporting and importing manufacturing SMEs per sector (2002)

sector (NACE) ⁶	number of firms	% export	% import
10	7	14%	14%
11	2	50%	50%
13	6	50%	83%
14	119	20%	30%
15	2,156	21%	25%
16	16	94%	69%
17	717	58%	55%
18	415	52%	45%
19	62	58%	37%
20	612	30%	32%
21	193	52%	61%
22	1,551	20%	17%
23	12	58%	67%
24	374	64%	57%
25	385	53%	58%
26	807	21%	29%
27	209	37%	40%
28	2,297	21%	24%
29	835	45%	45%
30	54	63%	39%
31	306	46%	38%
32	109	60%	40%
33	295	29%	22%
34	187	37%	41%
35	109	43%	33%
36	989	35%	29%
37	189	36%	48%
40	25	16%	16%
41	19	32%	11%
45	15,227	4%	4%
Total	28,284	17%	17%
total "core" manufacturing (NACE 15-37)	12,879	32%	32%

Source: VIO database

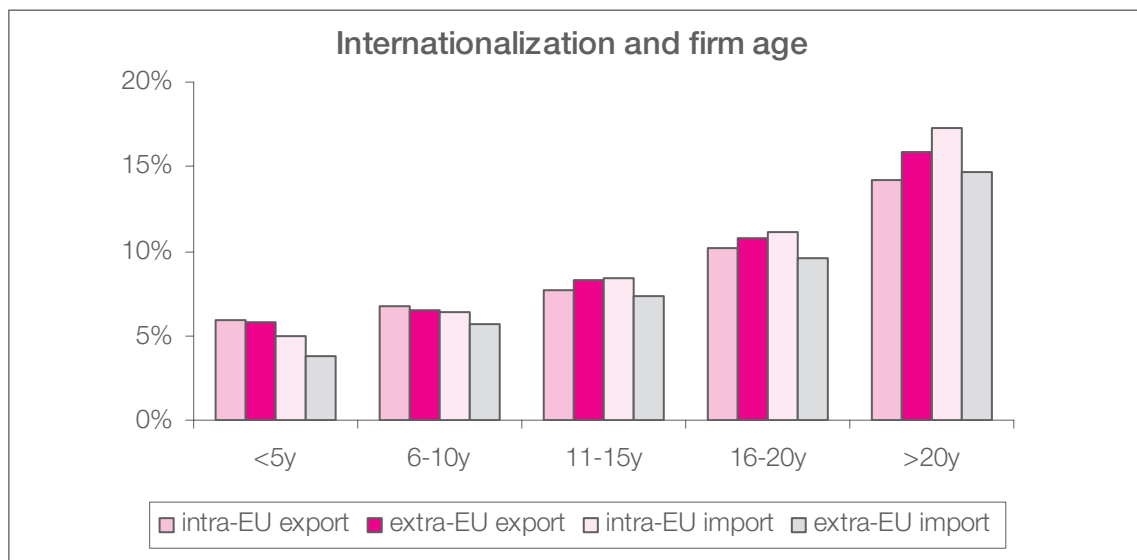
⁶ A list of NACE codes is included in appendix I.

The number of importers is almost exactly the same as the number of exporters: 17% across all manufacturing sectors, and 32% for the core manufacturing sectors. Again, differences across sectors are large, ranging from 4% in construction (45) to 83% in mining of metal ores (13).

Firm age

The proportion of exporting and importing SMEs increases with firm age. Less than 6% of firms younger than 5 years have intra-EU or extra-EU export. This percentage gradually increases with firm age. Almost 16% of firms of at least 20 years old have extra-EU export and 14% have intra-EU export. While younger firms (up to 10 years) export mainly to EU destinations, older firms tend to export more to countries outside the EU. Intra-EU import increases from 4% to 15% and extra-EU from 5% to 17% from the youngest to the oldest age class.

Figure 18 Percentage of exporting and importing manufacturing SMEs per age class (2002)

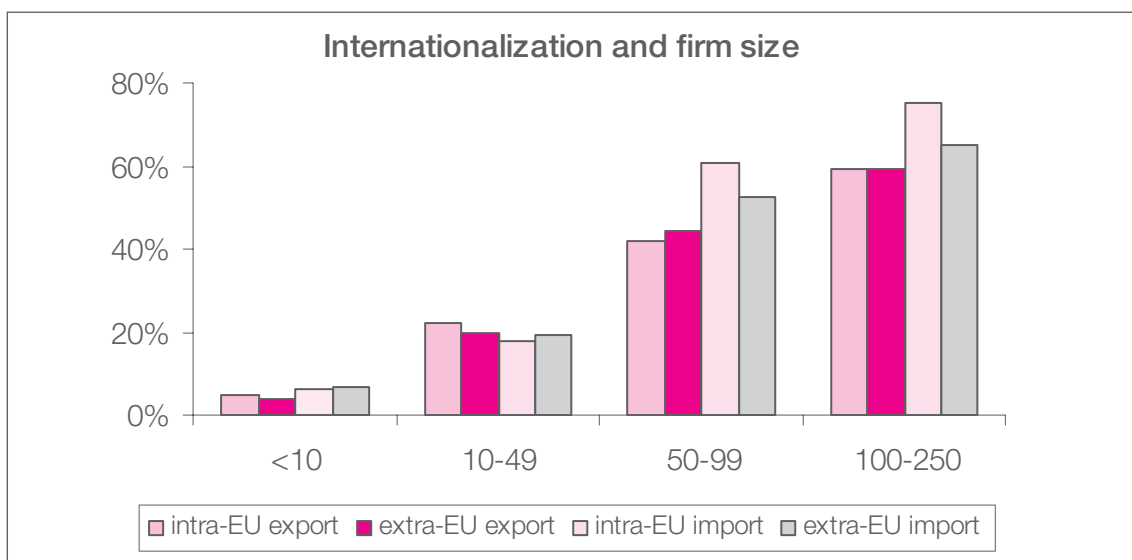


Source: VIO database

Firm size

Large SMEs import and export much more than smaller ones. Up to 57% of medium sized firms (50-250 employees) export, compared to less than 10% for micro enterprises (less than 10 employees).

Figure 19 Percentage of importing and exporting manufacturing SMEs per size class (2002)



Very few micro enterprises (less than 10 employees) export (5% within the EU, 4% to countries outside the EU). About 20% of small firms (10-49 employees) export. Almost 60% of firms with 100 to 250 employees export, and up to 75% of these firms import.

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Table 4 Percentage of importing and exporting manufacturing SMEs per size class (2002)

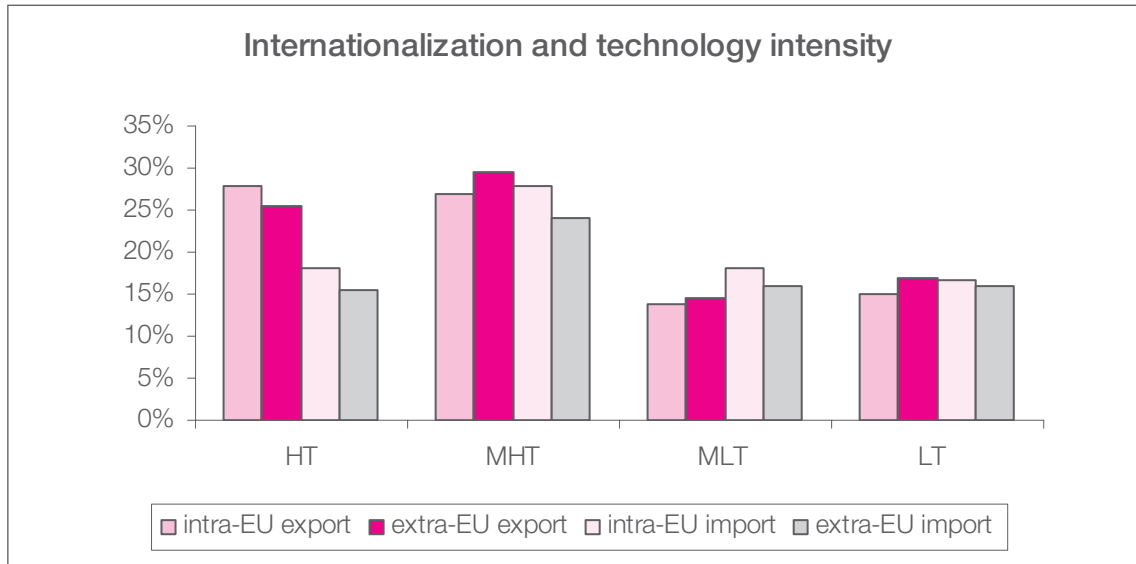
	SIZE			
	<10	10-49	50-99	100-250
intra-EU export	5.0%	22.2%	42.0%	59.1%
extra-EU export	4.0%	19.5%	44.2%	59.4%
intra-EU import	6.2%	17.8%	60.6%	75.1%
extra-EU import	6.6%	19.4%	52.3%	64.9%
N	20,204	3,809	812	345

Source: VIO database

Technology intensity

Twice as much high technology and medium high technology firms export compared to low and medium low technology firms. The share of medium high tech firms that export is about the same as high tech firms. In contrast, the share of importers is much higher among medium tech firms. In medium low technology sectors, more firms import than export, while in low tech sectors the shares are about the same.

Figure 20 Percentage of importing and exporting manufacturing SMEs per technology intensity class (2002)

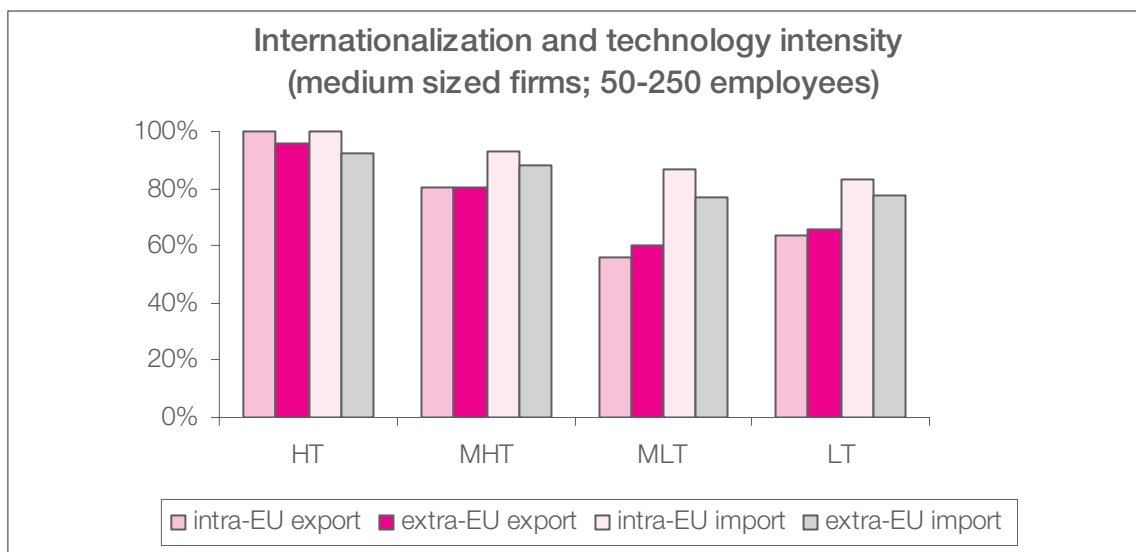


Source: VIO database

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Correcting for size by focusing on medium sized firms (50 to 250 employees) only, the impact of technology intensity becomes even more apparent. All medium sized firms in high technology industries export and import; more than 90% trade both with EU and non-EU partners.

Figure 21 Percentage of importing and exporting manufacturing medium sized enterprises per technology intensity class (2002)



Source: VIO database

About 60% of low tech and medium low tech firms export, and about 80% import. Remarkably, more firms in these sectors export to non-EU countries than to EU countries. In high tech sectors, 100% of firms export and import, while in less technology intensive sectors more firms import than export. In medium low tech sectors, 87% of firms import, while only 60% export.

5.3.2 Operating characteristics of exporting SMEs in manufacturing

To analyze the operations of exporting SMEs over time, the focus of this section is on firms that were active in 1998 and were still active in 2003. Of these firms reporting positive employment in 1998-2003, 3,998 (20%) were exporters in 2002⁷ and 15,972 were not. However, the majority of these non-exporting firms (9,637) were in construction, a sector which typically has a very low export rate. Focusing on the “core” manufacturing sectors (NACE 15-37), thus excluding construction, mining and utilities, 36% of these SMEs export. Nevertheless, to analyze the importing and non-importing SMEs in further detail, the next sections will focus on all manufacturing sectors.

Are exporters more productive?

Exporters, and especially those that have been exporting several years, have higher levels of productivity⁸ than non-exporters. This finding is consistent with empirical results in other countries, as shown in chapter 3. Not only do the higher productivity levels of exporters point to self selection of the more productive firms into exporting, the results further indicate that exporting may lead to increased productivity, through learning by exporting. More specifically, firms that started exporting, initially had higher productivity levels than non-exporters (self-selection), and increased productivity after starting to export (learning by exporting).

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Table 5 Labor productivity in Manufacturing SMEs (Value added per FTE employee, 1000 euro)

	X 1998	X 2002	#	Labor productivity 1998	Labor productivity 2003	Δ
Export		Y	3,979	53.1	58.7	+10.5%
Constant export	Y	Y	3,362	53.5	59.2	+10.7%
New to export	N	Y	1,094	50.9	56.3	+10.6%
Stopped export	Y	N	838	53.5	53.2	-0.6%
No export		N	18,072	46.8	52.2	+11.5%

Source: VIO database

Firms that were permanent exporters between 1998 and 2003 reported the highest productivity levels (€59,200 per FTE). All types of exporters were more productive than non-exporters. Only for those firms that stopped exporting, labor productivity dropped between 1998 and 2003. Although

⁷ Import and export data are used until 2002, and operating characteristics until 2003. The rationale behind this is that there may be a lag effect of exporting on firm operations, i.e. exporting in year x may lead to a change in operations in year x+1.

⁸ Labor productivity levels of firms were measured by the ratio of value added per FTE employee.

exporters are older and larger than non-exporters, no significant productivity differences were found for firms of different age or size classes.

Not only labor productivity was higher for SMEs that engaged in export activities. These firms also grew stronger in terms of employment, value added and labor productivity over time. The evolution of employment, value added and labor productivity over the 1998-2003 period is depicted in the next tables, showing the compound annual growth rate (CAGR) for different types of exporters and non-exporters.

Table 6 **Change in employment and value added in Manufacturing SMEs: CAGR (%) 1998-2003**

	export 1998	export 2002	#	Employment	Value added	Labor productivity
Export		Y	3,979	+1.1	+3.2	+2.0
Constant export	Y	Y	3,362	+0.6	+2.7	+2.1
New to export	N	Y	1,094	+3.7	+5.8	+2.0
Stopped export	Y	N	838	-0.9	-1.0	-0.1
No export		N	18,072	+0.7	+3.0	+2.2

Source: VIO database

Overall, firms that started exporting between 1998 and 2002 report the highest increase in employment (+3.7%) and value added (+5.8%). The highest increase in labor productivity is for non-exporters. These data are further analyzed for different age classes. Older, mature firms show different growth patterns than young, dynamic firms.

For all age classes, those firms that are new to export, i.e. those that did not export in 1998 and started exporting between 1998 and 2003, report the highest increase in employment and value added. Since both employment and value added increased rapidly in these firms, they do not always have the highest increase in labor productivity. Firms that stopped exporting, i.e. those that did export in 1998 and no longer exported in 2002, had the lowest, sometimes even negative growth of employment and value added. Across age categories, firms that have been active for 6 to 10 years report the highest growth in employment and value added, while the steepest increase in productivity comes from firms that are either 11-15 years old, or have been active for more than 20 years. The latter increase is due to a drop in employment, combined with a slight increase in value added.

Table 7 **Manufacturing SMEs started between 1993 and 1997 (6-10 years): CAGR (%) 1998-2003**

	export 1998	export 2002	Employment	Value added	Labor productivity
Export		Y	+4.2	+5.5	+1.2
Constant export	Y	Y	+3.2	+4.5	+1.3
New to export	N	Y	+9.2	+11.0	+1.6
Stopped export	Y	N	+0.4	+3.0	+2.6
No export		N	+5.8	+7.9	+2.0

Source: VIO database

Overall, the growth rates of non-exporters within this age group (6-10 years old) are higher than those of exporters. However, the fastest growth in employment and value added is for those SMEs that started exporting between 1998 and 2003. The firms that stopped exporting on the other hand, report the highest increase in labor productivity.

Table 8 Manufacturing SMEs started between 1988 and 1992 (11-15 years): CAGR (%) 1998-2003

	export 1998	export 2002	Employment	Value added	Labor productivity
Export		Y	+2.8	+5.2	+2.3
Constant export	Y	Y	+2.4	+4.6	+2.2
New to export	N	Y	+4.2	+7.5	+3.1
Stopped export	Y	N	+1.2	+3.6	+2.4
No export		N	+2.8	+5.1	+2.3

Source: VIO database

Within the group of services SMEs that have been active for 11-15 years, there are no significant differences in growth rates of exporters compared to importers. However, those firms that started importing report the highest growth in employment, value added and labor productivity.

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Table 9 Manufacturing SMEs started between 1983 and 1987 (16-20 years): CAGR (%) 1998-2003

	export 1998	export 2002	Employment	Value added	Labor productivity
Export		Y	+2.3	+3.0	+0.7
Constant export	Y	Y	+1.8	+2.2	+0.4
New to export	N	Y	+3.9	+6.1	+2.2
Stopped export	Y	N	-0.6	+1.7	+2.4
No export		N	+1.2	+3.8	+2.6

Source: VIO database

Within the group of services SMEs aged 16-20 years, exporters grow faster in terms of employment, while non-exporters have faster growth of value added and labor productivity. Again, the highest growth rates are for firms that started exporting.

Table 10 Manufacturing SMEs started before 1983 (> 20 years): CAGR (%) 1998-2003

	export 1998	export 2002	Employment	Value added	Labor productivity
Export		Y	-0.5	+1.9	+2.4
Constant export	Y	Y	-0.9	+1.6	+2.5
New to export	N	Y	+1.8	+3.6	+1.8
Stopped export	Y	N	-1.8	-3.4	-1.6
No export		N	-0.5	+2.0	+2.5

Source: VIO database

For the oldest group of services SMEs (older than 20 years), employment growth is negative for both exporters and non-exporters. Only those firms that started exporting between 1998 and 2003 report positive employment growth. These firms also have the fastest growth in value added, while permanent exporters report the highest growth in labor productivity.

Overall, the fastest growth in employment and value added is reported by firms that have recently started exporting, regardless of firm age. However, these growth rates decline with firm age.

5.3.3 International new ventures

From the database, two types of rapidly internationalizing SMEs can be identified: current exporters established in 1998 or later; and firms founded in 1993-1997 that started exporting within five years from inception. The former will be the focus of this section, since these more recently established international new ventures⁹ best capture the recent evolutions, and are still relatively small in scale.

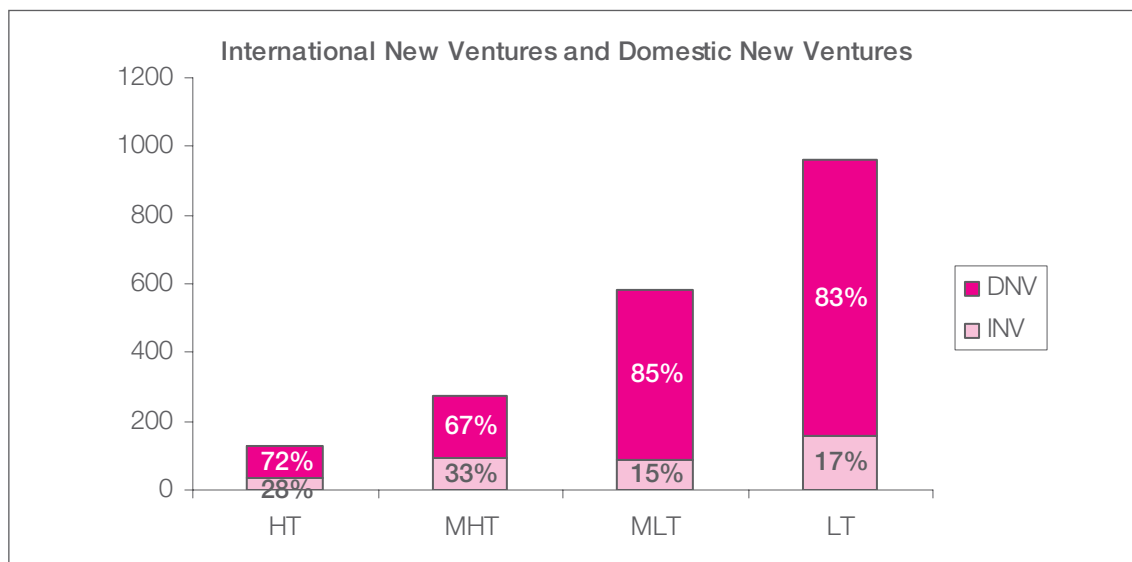
Although these firms report spectacular growth rates, the number of international new ventures is limited. 453 (9.9%) of the 4,570 firms established in 1998 or later that were still active in 2002, reported export in 2002. Of these international new ventures, 25 were established in 1998.

Sector distribution

International New Ventures are especially active in the high tech industries (both high and medium high tech). Often such firms offer very specific niche products, for which the domestic market is too small and therefore they are pushed to internationalize relatively soon.

⁹ The dataset does not provide information on the scope of these SMEs' international activities. Consequently, the scope of the export activities (number of export destinations and share of sales in foreign markets) is not taken into account and no distinction has been made between international new venture and other rapidly internationalizing SMEs.

Figure 22 Percentage of international new ventures and domestic new ventures per technology intensity class (2002)



Source: VIO database

Although the highest number of INVs is in low technology sectors (160 firms vs. 36 firms in high technology), the percentage of INVs is much higher in high tech and medium-high tech sectors.

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Productivity

Employment in the 25 INVs established in 1998 doubled between 1998 and 2003, from an average of 18 employees to 36 employees per firm. Value added more than doubled (+120%). These growth rates are substantially higher than those of the 153 domestic new ventures (DNVs) established in 1998, i.e. firms that had no export in 2002. However, these firms report a steeper increase in labor productivity (+3.8% per year, compared to +2.1% for international new ventures).

Table 11 Evolution of employment, value added and labor productivity of international new ventures and domestic new ventures, 1998-2003 (CAGR, %)

	Employment	Value added	Labor productivity
INV	+14.7	+17.1	+2.1
DNV	+7.6	+11.7	+3.8

Source: VIO database

Geographical scope

The export destinations of international new ventures are not significantly different from those of more mature firms. About 30% export only to EU countries, 28% only to countries outside the EU, and 41% export both within and outside the EU. Almost half (46%) of international new ventures have foreign suppliers both in the EU and in other countries. 36% import only from EU suppliers and 18% only from outside the EU.

5.3.4 Operating characteristics of importing SMEs in manufacturing

Firms active in 1998 and still active in 2003

4,271 firms (20%) reporting positive employment over the period 1998-2003 were importers in 2002; 16,701 were not. However, the majority of these non-importing firms (10,182) were in construction, a sector which typically has a very low import rate. Focusing on the “core” manufacturing sectors (NACE 15-37), thus excluding construction, mining and utilities, 37% of all Belgian manufacturing SMEs import.

Nevertheless, to analyze the importing and non-importing SMEs in further detail, the next sections will focus on all manufacturing sectors.

Table 12 Change in employment and value added in Manufacturing SMEs: CAGR (%) 1998-2003

	import 1998	import 2002	#	Employment	Value added	Labor productivity
Import		Y	4,271	+0.5	+2.7	+2.1
Constant import	Y	Y	3,426	-0.0	+2.1	+2.1
New to import	N	Y	814	+5.3	+8.4	+2.9
Stopped import	Y	N	327	-5.8	-5.3	+0.5
No import		N	16,701	-0.1	+2.3	+2.3

Source: VIO database

Overall, firms that started importing between 1998 and 2002 report the highest increase in employment (+5.3%) and value added (+8.4%) and labor productivity (+2.9%). Both employment and value added dropped steeply in firms that no longer import. These data are further analyzed for different age classes. Older, mature firms show different growth patterns than young, dynamic firms.

For all age classes, those firms that are new to import, i.e. those that did not import in 1998 and started importing between 1998 and 2003, report the highest increase in employment and value added. This is consistent with the results for export. Except for those firms aged between 5 and 10 years, those firms that stopped importing drastically reduced employment, sometimes accompanied by a drop in value added.

Table 13 Manufacturing SMEs started between 1993 and 1997 (6-10 years): CAGR (%) 1998-2003

	import 1998	import 2002	Employment	Value added	Labor productivity
Import		Y	+3.9	+5.6	+1.6
Constant import	Y	Y	+3.0	+4.8	+1.8
New to import	N	Y	+9.0	+10.2	+1.1
Stopped import	Y	N	+5.3	+8.5	+3.0
No import		N	+6.2	+8.2	+1.9

Source: VIO database

Of those services SMEs aged 6-10 years, the firms that started importing between 1998 and 2003 had the highest growth in employment (+9.0%) and value added (+10.2%). The SMEs that stopped importing on the other hand, report the highest increase in labor productivity.

Table 14 Manufacturing SMEs started between 1988 and 1992 (11-15 years): CAGR (%) 1998-2003

	import 1998	import 2002	Employment	Value added	Labor productivity
Import		Y	+2.9	+4.9	+2.0
Constant import	Y	Y	+2.3	+4.2	+1.9
New to import	N	Y	+6.3	+9.3	+2.8
Stopped import	Y	N	-0.7	+5.6	+6.4
No import		N	+2.7	+5.3	+2.5

Source: VIO database

Similar to the group of firms aged 6-10 years, within the group of services SMEs that have been active for 11-15 years, those firms that started importing report the highest growth in employment (+6.3%) and value added (+9.3%), and those firms that stopped importing report the highest increase in labor productivity (+6.4%).

Table 15 Manufacturing SMEs started between 1983 and 1987 (16-20 years): CAGR (%) 1998-2003

	import 1998	import 2002	Employment	Value added	Labor productivity
Import		Y	+2.6	+3.5	+0.8
Constant import	Y	Y	+2.1	+2.8	+0.7
New to import	N	Y	+6.6	+8.9	+2.1
Stopped import	Y	N	-3.1	+0.1	+3.3
No import		N	+0.7	+3.4	+2.6

Source: VIO database

Within the group of services SMEs aged 16-20 years, importers grow faster in terms of employment, while there is no marked difference in growth of value added. Again, the highest growth rates are for firms that started importing, while the highest growth in labor productivity is for SMEs that stopped importing.

Table 16 Manufacturing SMEs started before 1983 (> 20 years): CAGR (%) 1998-2003

	import 1998	import 2002	Employment	Value added	Labor productivity
Import		Y	-0.2	+2.3	+2.5
Constant import	Y	Y	-0.5	+1.9	+2.5
New to import	N	Y	+3.2	+6.2	+2.8
Stopped import	Y	N	-10.5	-12.6	-2.4
No import		N	-0.9	+1.4	+2.3

Source: VIO database

For the oldest group of services SMEs (older than 20 years), employment growth is negative for both importers and non-importers. Only those firms that started importing between 1998 and 2003 report positive employment growth. These firms also have the fastest growth in value added and labor productivity. Those SMEs that stopped importing report a steep drop in employment (-10.5%) and value added (-12.6%).

5.4 Services

In this section, the internationalization of all Belgian (domestic owned) services (NACE 50-74) SMEs (less than 250 employees and turnover less than €50 million) with at least 1 FTE will be analyzed.

5.4.1 Mode and geographical scope of internationalization

Of the 65,941 services SMEs employing at least 1 FTE in 2002, the majority (74%) had no international activities. Of the 17,332 internationalized services SMEs, 5,978 both import and export. 4,251 firms only import; of which 756 import from both EU and non-EU countries. 7,103 only export; of which 1,286 export to EU and non-EU countries.

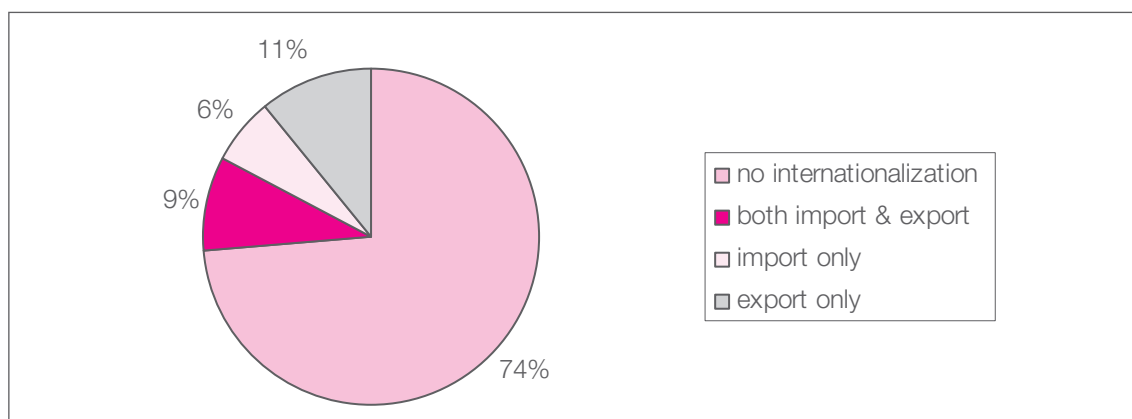
Table 17 Mode of internationalization of Belgian SMEs in services (2002)

		intra-EU	extra-EU	both
no internationalization	48,609			
both import & export	5,978	1,130	424	4,424
import only	4,251	3,028	467	756
export only	7,103	2,491	3,326	1,286

Source: VIO database

In contrast with manufacturing, where the combination of both import and export was the most common mode of internationalization, most internationalized services SMEs (11%) only export. A smaller share (9%) import and export, while 6% only import.

Figure 23 Mode of internationalization of Belgian SMEs in services (2002)



Source: VIO database

SMEs are often involved in more than one form of internationalization. About 50% of importing firms also export. Up to 67% of firms that import from outside the EU also import from within the EU. Table 18 shows for each row the percentage of firms engaged in other international activities.

Table 18 Percentage of exporting and importing services SMEs with other international activities (2002)

	import		export	
	intra-EU	extra-EU	intra-EU	extra-EU
intra-EU import	100.0	36.8	44.5	37.5
extra-EU import	67.7	100.0	55.2	59.4
intra-EU export	46.7	31.5	100.0	47.9
extra-EU export	37.2	32.1	45.2	100.0

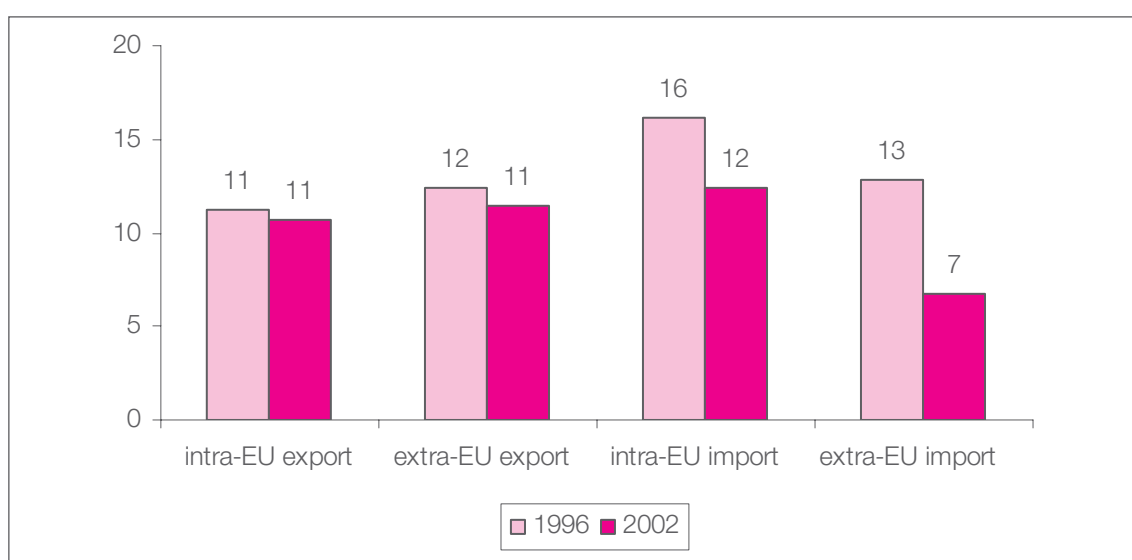
Source: VIO database

The link between different modes of internationalization and geographical scope is less strong than in manufacturing. Only 36.8% of firms with intra-EU imports also import from outside the EU. Firms with extra-EU imports are more likely to have exports than firms with only intra-EU export. 46.7% of intra-EU exporters also have intra-EU imports, and 31.5% have extra-EU imports.

Evolution in geographical scope of internationalization

In 2002, about 11% of services firms had intra-EU export and a similar proportion exported to countries outside the EU. This percentage is slightly lower compared to 1996. In contrast, the percentage of importing firms dropped from 16% in 1996 to 12% in 2002 for intra-EU import and from 13% to 7% for extra-EU import.

Figure 24 Evolution in geographical scope in internationalization of Belgian services SMEs (1996-2002)



Source: VIO database

Export and import by sector

On average, 17% of services firms export and 14% import. However, substantial differences exist across sectors. In sectors like wholesale (51), air transport (62) and research & development (73), a large proportion of firms export. In some other sectors, the number of exporters is insignificant. In most services sectors, only a marginal fraction of firms import. Only in wholesale (51), a sizeable number of firms (41%) import. Leaving out this sector in the analysis would bring the average percentage of importers in services to only 7%.

Table 19 Percentage of exporting and importing services SMEs per sector (2002)

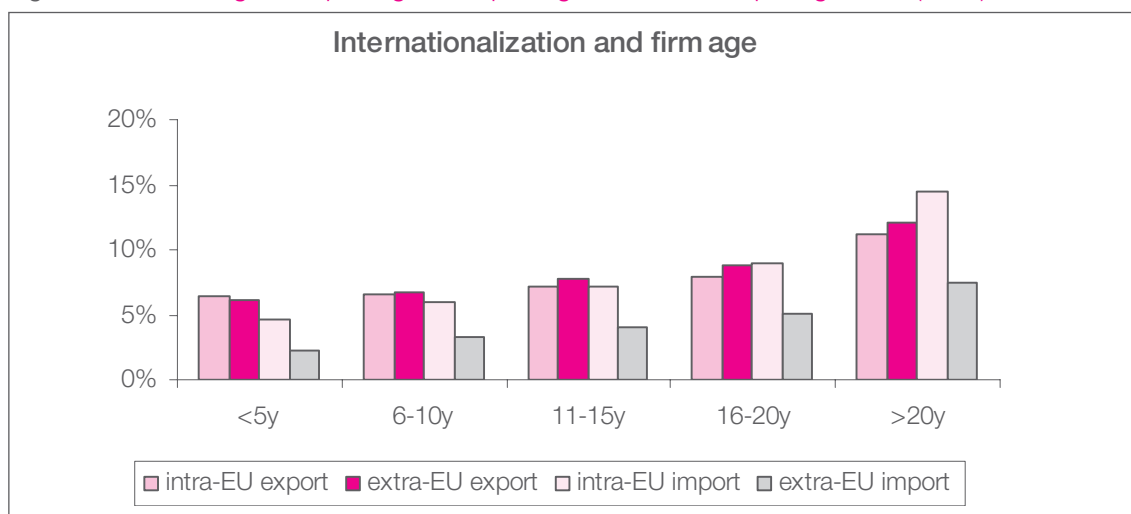
sector (NACE)	number of firms	% export	% import
50	5,510	28%	16%
51	14,047	39%	41%
52	12,366	13%	13%
55	6,625	2%	1%
60	3,891	8%	2%
61	109	12%	2%
62	16	50%	0%
63	1,493	16%	3%
64	239	15%	4%
65	1,061	3%	2%
66	14	7%	0%
67	1,865	1%	0%
70	2,443	2%	1%
71	645	13%	9%
72	1,604	15%	6%
73	62	37%	8%
74	10,800	7%	3%
Total	62,790	17%	14%

Source: VIO database

Firm age

The proportion of exporting and importing firms increases with firm age. Just over 6% of firms younger than 5 years have intra-EU or extra-EU export. This percentage gradually increases with firm age, although differences are smaller than in manufacturing. About 12% of firms of at least 20 years old have extra-EU export and 11% have intra-EU export. Intra-EU import increases from 5% to 15% and extra-EU from 2% to 8% from the youngest to the oldest age class.

Figure 25 Percentage of importing and exporting services SMEs per age class (2002)



Source: VIO database

Firm size

Analogous to age, firms become more internationalized with increasing size.

Table 20 Percentage of importing and exporting services SMEs per size class (2002)

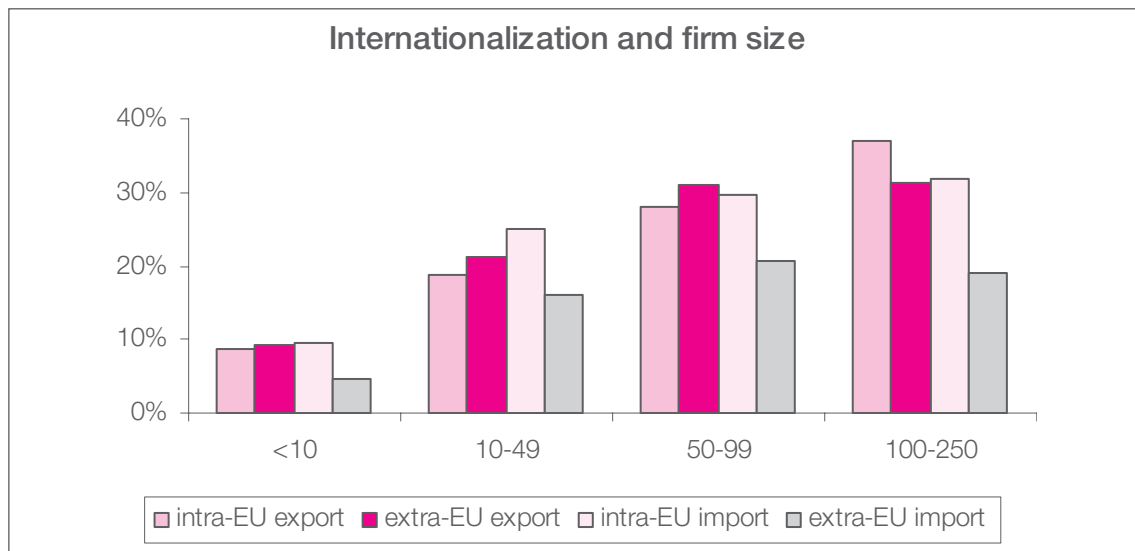
	SIZE			
	<10	10-49	50-99	100-250
intra-EU export	8.8%	18.9%	28.0%	37.0%
extra-EU export	9.2%	21.3%	31.2%	31.3%
intra-EU import	9.6%	25.0%	29.7%	31.7%
extra-EU import	4.6%	16.1%	20.6%	19.1%
N	51,844	10,090	626	230

Source: VIO database

Interestingly, a higher proportion of micro enterprises in services export, compared to those in manufacturing. In contrast, for all categories of larger services SMEs, the proportion of internationalized firms is substantially lower than in the same size classes in manufacturing.

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Figure 26 Percentage of importing and exporting services SMEs per size class (2002)



Source: VIO database

5.4.2 Operating characteristics of exporting SMEs in services

To analyze the operations of exporters over time, the focus of this section is on firms that were active in 1998 and still active in 2003. Of these firms reporting positive employment over the period 1998-2003, 7,491 (20%) were exporters in 2002 and 30,423 were not.

Are exporters more productive?

Exporters, and especially those that have been exporting several years, have higher levels of productivity¹⁰ than non-exporters. This finding is consistent with empirical results in other countries, as shown in chapter 3. Contrary to the findings in manufacturing, exporters were not always more productive than non-exporters. SMEs that are new to export reported the lowest labor productivity. SMEs that were permanent exporters between 1998 and 2003 reported the highest productivity levels (€ 68,700 per FTE). Except for firms that were new to export, exporters were more productive than non-exporters.

Table 21 Labor productivity in Services SMEs (Value added per FTE employee, 1000 euro)

	export 1998	export 2002	#	Labor productivity 1998	Labor productivity 2003	Δ
Export		Y	7,491	61.9	67.0	+8.2%
Constant export	Y	Y	5,285	63.3	68.7	+8.5%
New to export	N	Y	2,206	57.2	62.2	+8.7%
Stopped export	Y	N	2,227	60.5	64.7	+6.9%
No export		N	30,423	58.4	63.4	+8.6%

Source: VIO database

The evolution of employment, value added and labor productivity over the 1998-2003 period is depicted in the next tables, showing the compound annual growth rate (CAGR) for different types of exporters and non-exporters.

Table 22 Change in employment and value added in Services SMEs: CAGR (%) 1998-2003

	export 1998	export 2002	#	Employment	Value added	Labor productivity
Export		Y	7,491	+3.5	+5.1	+1.6
Constant export	Y	Y	5,285	+3.0	+4.7	+1.6
New to export	N	Y	2,206	+5.0	+6.8	+1.7
Stopped export	Y	N	2,227	+1.9	+3.3	+1.3
No export		N	30,423	+2.8	+4.5	+1.7

Source: VIO database

¹⁰ Labor productivity levels of firms were measured by the ratio of value added per FTE employee.

Overall, firms that started exporting between 1998 and 2002 reported the highest increase in employment (+5.0%) and value added (+6.8%) and the highest increase in labor productivity (+1.7%). These data are further analyzed for different age classes. Older, mature firms show different growth patterns than young, dynamic firms.

For all age classes, those firms that were new to export, i.e. those that did not export in 1998 and started exporting between 1998 and 2003, reported the highest increase in employment and value added. Since both employment and value added increased rapidly in these firms, they did not always show the highest increase in labor productivity.

Table 23 *Services SMEs started between 1993 and 1997 (6-10 years): CAGR (%) 1998-2003*

	export 1998	export 2002	Employment	Value added	Labor productivity
Export		Y	+6.9	+8.2	+1.2
Constant export	Y	Y	+5.1	+6.3	+1.1
New to export	N	Y	+11.6	+14.0	+2.1
Stopped export	Y	N	+8.1	+7.2	-0.8
No export		N	+6.7	+8.7	+1.9

Source: VIO database

Overall, the growth rates of exporters and non-exporters within this age group (6-10 years) do not differ much. However, those services SMEs that started importing between 1998 and 2003 had the highest growth in employment (+11.6%), value added (+14.0%) and labor productivity (+2.1%). Non-exporters report negative growth in labor productivity (-0.8%).

Table 24 *Services SMEs started between 1988 and 1992 (11-15 years): CAGR (%) 1998-2003*

	export 1998	export 2002	Employment	Value added	Labor productivity
Export		Y	+4.9	+6.3	+1.3
Constant export	Y	Y	+4.7	+6.2	+1.4
New to export	N	Y	+5.6	+6.7	+1.1
Stopped export	Y	N	+3.8	+4.5	+0.6
No export		N	+4.1	+5.9	+1.8

Source: VIO database

Similar to the group of firms aged 6-10 years, within the group of services SMEs that have been active for 11-15 years, those firms that started exporting report the highest growth in employment and value added. Those firms that stopped exporting had the slowest growth rates. Non-exporters had the highest growth in labor productivity.

Table 25 *Services SMEs started between 1983 and 1987 (16-20 years): CAGR (%) 1998-2003*

	export 1998	export 2002	Employment	Value added	Labor productivity
Export		Y	+3.6	+5.8	+2.1
Constant export	Y	Y	+3.6	+5.6	+1.9
New to export	N	Y	+3.4	+6.3	+2.8
Stopped export	Y	N	+2.4	+6.3	+3.9
No export		N	+2.5	+0.7	-1.8

Source: VIO database

Within the group of services SMEs aged 16-20 years, exporters grow faster in terms of employment, value added and labor productivity than non-exporters. Again, the highest growth rates are for firms that started exporting. Non-importers had negative growth in labor productivity (-1.8%).

Table 26 *Services SMEs started before 1983 (> 20 years): CAGR (%) 1998-2003*

	export 1998	export 2002	Employment	Value added	Labor productivity
Export		Y	+1.9	+3.4	+1.5
Constant export	Y	Y	+1.6	+3.2	+1.6
New to export	N	Y	+3.1	+4.4	+1.2
Stopped export	Y	N	-0.4	+0.8	+1.2
No export		N	+0.3	+3.3	+3.0

Source: VIO database

For the oldest group of services SMEs (older than 20 years), importers grow much faster in terms of employment (+1.9% versus +0.3%) than non-importers, while the difference in growth of value added is rather small (+3.4% versus +3.3%). Non-importers reported the highest growth in labor productivity (+3.0%). Also for this age group, the fastest growth is for those SMEs that started importing, while those that stopped importing report negative growth for employment (-0.4%).

Overall, services SMEs perform better in terms of growth than manufacturing SMEs. Exporting services SMEs, and especially those that recently started exporting, grow faster in terms of employment and value added than their non-exporting counterparts.

5.4.3 Operating characteristics of importing SMEs in services

To analyze the operations of importers over time, the focus of this section is on firms that were active in 1998 and were still active in 2003. Of these 37,914 firms, 19% were importers in 2002; 81% were not.

Overall, firms that started importing between 1998 and 2002 reported the highest increase in employment (+7.5%) and value added (+9.8%) and the highest increase in labor productivity (+2.1%).

Table 27 Change in employment and value added 1998-2003: CAGR (%) 1998-2003

	import 1998	import 2002	#	Employment	Value added	Labor productivity
Import		Y	7,080	+3.4	+5.5	+2.0
Constant import	Y	Y	5,440	+2.5	+4.6	+2.1
New to import	N	Y	1,640	+7.5	+9.8	+2.1
Stopped import	Y	N	673	-1.2	-1.1	+0.1
No import		N	30,834	+2.8	+4.3	+1.5

Source: VIO database

These data are further analyzed for different age classes. For all age classes, those firms that were new to export, i.e. those that did not export in 1998 and started exporting between 1998 and 2003, reported the highest increase in employment and value added. Since both employment and value added increased rapidly in these firms, they did not always show the highest increase in labor productivity.

Table 28 Services SMEs started between 1993 and 1997 (6-10 years): CAGR (%) 1998-2003

	import 1998	import 2002	Employment	Value added	Labor productivity
Import		Y	+6.7	+8.0	+1.2
Constant import	Y	Y	+3.7	+5.3	+1.6
New to import	N	Y	+13.7	+15.0	+1.2
Stopped import	Y	N	-3.1	-0.3	+2.8
No import		N	+6.8	+8.7	+1.9

Source: VIO database

Overall, the growth rates of importers and non-importers within this age group do not differ much. However, marked differences exist between those SMEs that stopped importing, and those that started importing. Of those services SMEs established between 1993 and 1997, the firms that started importing between 1998 and 2003 had the highest growth in employment (+13.7%) and value added (+15.0%). The firms that stopped importing on the other hand, report negative growth in employment (-3.1%) and value added (-0.3%). Because the drop in employment is much steeper than the one in value added, these SMEs report the highest increase in labor productivity.

Table 29 Services SMEs started between 1988 and 1992 (11-15 years): CAGR (%) 1998-2003

	import 1998	import 2002	Employment	Value added	Labor productivity
Import		Y	+5.3	+7.1	+1.7
Constant import	Y	Y	+4.1	+6.1	+1.9
New to import	N	Y	+9.7	+11.1	+1.2
Stopped import	Y	N	+1.7	+3.1	+1.4
No import		N	+3.9	+5.7	+1.6

Source: VIO database

Similar to the group of firms aged 6-10 years, within the group of services SMEs that have been active for 11-15 years, those firms that started importing report the highest growth in employment and value added, while those firms that stopped importing had the slowest growth rates. Firms that have been permanently importing between 1998 and 2003 have the highest increase in labor productivity. In general, importers report higher growth rates in employment (+5.3% versus +3.9%) and value added (+7.1% versus +5.7%) compared to non-importers.

Table 30 **Services SMEs started between 1983 and 1987 (16-20 years): CAGR (%) 1998-2003**

	import 1998	import 2002	Employment	Value added	Labor productivity
Import		Y	+3.9	+7.2	+3.1
Constant import	Y	Y	+3.5	+6.9	+3.3
New to import	N	Y	+5.8	+8.9	+2.9
Stopped import	Y	N	+2.6	-4.7	-7.2
No import		N	+2.4	+0.1	-2.3

Source: VIO database

Within the group of services SMEs aged 16-20 years, importers grow faster in terms of employment, value added and labor productivity than non-importers. Again, the highest growth rates are for firms that started importing, while the highest growth in labor productivity is for permanent importers. Non-importers had hardly any growth in value added (+0.1%) and negative growth in labor productivity.

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Table 31 **Services SMEs started before 1983 (> 20 years): CAGR (%) 1998-2003**

	import 1998	import 2002	Employment	Value added	Labor productivity
Import		Y	+1.8	+3.6	+1.8
Constant import	Y	Y	+1.3	+3.1	+1.8
New to import	N	Y	+4.3	+6.6	+2.2
Stopped import	Y	N	-3.4	-2.7	+0.7
No import		N	+0.3	+3.1	+2.8

Source: VIO database

For the oldest group of services SMEs (older than 20 years), importers grow much faster in terms of employment (+1.8% versus +0.3%) than non-importers, while the difference in growth of value added is rather small (+3.6% versus +3.1%). Non-importers reported the highest growth in labor productivity. Also for this age group, the fastest growth is for those SMEs that started importing, while those that stopped importing report negative growth for both employment and value added.

In general, for all age groups, importing services SMEs, and especially those that recently started importing, grow faster in terms of employment and value added than non-importing services SMEs.

A large number of SMEs have never considered internationalization (European Commission, 2004). The first policy objective should be targeted at increasing the awareness about the benefits of internationalization within this group of entrepreneurs. Spence (2003) claims that the awareness of export promotion programs among non-exporters is low. As the entrepreneur is key to the successful internationalization of the SME, the focus of policy support mechanisms should be the decision maker, often the owner-manager (Lloyd-Reason & Mighan, 2002). For successful internationalization, the owner-manager needs to have an international orientation. As the owner-manager can influence every aspect of firm behavior, it is critical to take his impact on the potential strengths, weaknesses and needs of the firm into account (Fisher & Reuber, 2004). In a second phase, the skills and resource base of the firm should be targeted.

In a UK study on SMEs' use and awareness of government export assistance programs, Crick (1997) found that firms in different stages of internationalization have different needs for government export assistance. Therefore, support should be tailored to firms with different degrees of export commitment, rather than offering generic government assistance to all firms. For those firms that do not export, a distinction should be made between those that are ready to export and those firms that are not.

Acs et al. (2001) argue that the activities of support agencies may actually be counterproductive to the long-term interests of many SMEs. SMEs are often pushed toward direct exporting, rather than indirect exporting by entering the value chain of established multinational enterprises (MNEs). They suggest especially highly innovative SMEs might be better off leaving the internationalization of their products to MNEs and sharing the exporting profits with them. Policy measures should be aimed at reducing entry barriers and lowering the cost of international expansion (Acs et al., 1997), such as the protection of property rights, and transaction costs.

Export programs aimed at old firms with little or no export experience, will not generate a high return, as these firms generally have only limited export potential (Moen & Servais, 2002). Old firms with high export involvement appear to have the highest export potential, while many newly established exporting firms are also promising. Hessels & Van Stel (2006) suggest governments should focus on new ventures with high export ambitions. Export promotion programs should target those entrepreneurs who have high growth abilities and ambitions. Andersson et al. (2004) also suggests targeting those firms that are not international, but have growth ambitions. According to Mayer & Ottaviano (2007), the number of firms that engage in export and FDI is the most important factor for a country's trade and FDI performance. Governments should thus develop policies that broaden the export base. Although most authors seem to agree it is most beneficial to increase the number of exporters, Westhead et al. (2004) on the other hand suggest policy makers should maximize their investment returns by encouraging existing exporters to export more, rather than increasing the number of exporting firms.

As it is evident that good firms become exporters, but the subsequent benefits of exporting are less clear, Bernard & Jensen (1999) suggest aiding current exporters might target the wrong firms. The most apparent benefits of exporting are the increased probability of survival and higher employment growth. However, as exporting entails several risks, and given the negative consequences of stopping

export, policies should target only those firms that are export ready. Reducing entry costs for these firms, by offering export assistance, information programs and joint marketing efforts, would be an appropriate way to push these firms to exporting.

Lloyd-Reason & Sear (2007) indicate a number of policy mismatches between the needs of globally trading SMEs and support agencies. Support agencies focus too much on export, as compared to other forms of internationalization. The emphasis is on trade promotion (opportunity spotting) rather than trade development (managing global opportunities). The dominant rationale behind this is still the traditional approach of developing global activities through stages. Another aspect of internationalization that does not receive enough policy attention is the increasing number of SMEs that internationalize in order to access know-how, technology and labor (European Commission, 2004). Exploiting the opportunities of globalization implies not only exporting and spreading activities across the globe. Sourcing goods and services from different regions of the world should also be part of this strategy (Coucke & Sleuwaegen, 2007).

Policy frameworks need to be flexible enough to respond to the increasing complexity and uncertainty SMEs face while competing internationally. Lloyd-Reason & Sear (2007) suggest that, in order to effectively support globally trading SMEs, support measures should be adjusted. Policy should take initiatives to develop an international entrepreneurial environment. Support agencies should consider other forms of internationalization than export.

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Kirby & Kaiser (2003) point to the emergence of joint ventures as an internationalization strategy for SMEs. Support programs could play an important role in assisting SMEs in identifying foreign business partners. Since the global marketplace is a rapidly changing environment, support agencies need to keep track of the changes and adjust their support measures. New markets and new ways of internationalization, such as partnerships or direct investment, and new sectors offer opportunities for the internationalization of SMEs (Hessels & Stigter, 2004). Furthermore, small firms are internationalizing at a much earlier age than before (Andersson et al., 2004). This implies that government policy and support towards SMEs should be adjusted to these changes.

A number of recent studies indicate a need for more customized support (e.g. Ibeh, 2003). Programs providing direct and active support to SMEs should combine a number of factors, such as access to information, competency development and hands-on, individual service. Ibeh (2003) suggests policy should focus on developing the entrepreneurial competencies and international orientation. The necessary skills and knowledge to manage globally need to be developed, and networks and relationships need to be supported.

A straightforward approach to assist internationalizing SMEs would be to reduce or remove existing barriers to internationalization. An often mentioned barrier to internationalization is regulations and red tape. Therefore, policy measures should aim at reducing these barriers, rather than further increasing the administrative burden SMEs already have to deal with. Lloyd-Reason & Sear (2007) identify a number of barriers perceived by US based SMEs. Support agencies can play an important role in reducing most of these barriers, including those related to lack of information and finding reliable partners.

Most EU member states have specific policies to support the internationalization of SMEs. These generally comprise different types of support, ranging from basic information or export promotion

to company-specific measures including individual consulting and competency development. Policy measures can be categorized into five types of support: information, promotion, financial support, inward investment support and counseling (European Commission, 2004). Most countries offer standard information services and promotion, such as support for participation in trade fairs or trade missions. However, Mayer & Ottaviano (2007) claim that trade missions do not generate trade. Spence (2003) states that while trade missions do facilitate market entry, they do not attract non-exporters. Financial support may include export credit or insurance, internationalization support grants and in a few countries even tax relief. Inward investment support comprises FDI information or financial support. Arguably the most effective support measure is individual counseling. This may include advice on export development, the establishment of subsidiaries abroad, competence development, the identification of partners and legal advice. However, there seems to be a significant gap between the need SMEs have for planning their international activities and the actions in relation to these activities. Therefore, SMEs could benefit from assistance in choosing, planning and deploying the right strategy.

A Spanish program providing support to SMEs that want to start foreign activities combines advice of the Spanish institution for foreign promotion with assistance from an external specialist. Next to financial support, the services include individualized and specialized advice and complementary services designed especially for the SME such as translation, insurance, financial services, information, training and promotion (European Commission, 2004). The program is based on an assessment of the competitive position and the internationalization potential of the SME. Next to the internal assessment, the opportunities in the foreign market are identified through market research. The firm is guided through the whole process, including the implementation of the internationalization plan. After the implementation, a monitoring program aims to guarantee the firm's status as regular exporter.

This example is in contrast with the often rather generic services offered by support agencies in other countries or regions. Key learning points are the customized support in combination with external experts, and the monitoring program. Support agencies often limit their role to information services and financial support, after which there is no follow up of the impact of the assistance on the SME's internationalization performance.

Recommendations to improve support

Based on the review of studies dealing with SME internationalization policies and the findings of this study, the following recommendations are made to improve the current situation in Flanders.

1. Increase awareness. Many SMEs have never considered internationalization. More entrepreneurs should be made aware of the possible benefits of internationalization.
2. Target firms that are export ready. Policies should target firms that are new to export, while making sure that these firms are export ready. This implies that these SMEs are prepared and ready to make the necessary investments and take the risks involved in internationalization.
3. Help entrepreneurs acquire the capabilities needed to internationalize. Lack of skills or skilled human capital to engage in internationalization is an often cited barrier for SMEs. Improving skills

has a long term effect on the internationalization of SMEs. It can further help those firms that are not export ready to gain the necessary skills and prepare them for internationalization.

4. Target new firms. New ventures with high ambition and the ability to realize these ambitions, have a great export potential. Supporting these firms can thus generate a high return, on the condition that these firms are export ready.
5. Offer tailored support. Export support is often generic, while diversity among SMEs is increasing. Support measures should be customized to better respond to the needs of these SMEs.
6. Offer specific programs for international new ventures. Support is often still based on the assumption that firms internationalize in stages. Rapidly internationalizing SMEs would benefit from measures that address the specific issues faced by young firms that want to reach clients in multiple countries.
7. Integrate internationalization support in a broader range of support measures targeted towards SMEs. Some countries (e.g. Ireland, Finland) have merged internationalization and innovation support.
8. Broaden the range of services. Support is often oriented towards increasing export by trade missions and financial support. There is an increasing need among SMEs for reliable information and help in identifying foreign business partners.
9. Follow up. Long term follow up and measuring the impact of support can help improve the effectiveness of specific measures.
10. Reduce barriers and entry costs. SMEs suffer from disadvantages of scale and often have problems in overcoming the costs and barriers involved in internationalization. Reducing these costs and barriers can thus increase the number of SMEs engaging in international activities.
11. Reduce red tape. An important barrier to export is red tape. Effective support measures should help entrepreneurs to reduce red tape and not confront them with an even higher administrative burden.
12. Stimulate cooperation. Linking with existing MNEs can help SMEs in circumventing barriers to internationalization. Developing clusters and assisting SMEs in establishing partnerships can increase the possible benefits of international cooperation.

The effectiveness of government support could further be improved by integrating policies on entrepreneurship, innovation and internationalization. Stimulating entrepreneurship and internationalization can increase the number of starters and exporters. Innovative firms should be encouraged to market their products abroad.

Policies supporting internationalization in Belgium are scattered among different agencies. Next to the regional export promotion agencies Flanders Investment and Trade (Flanders), AWEX, (Wallonia) and Brussels Export (Brussels), federal organizations such as Finexpo, BMI and Delcredere also offer export support. On a regional Flemish level, internationalization is supported by Flanders Investment and Trade (F.I.T.) and PMV. Next to those organisations, other public bodies such as VLAO and IWT play a role in identifying potential exporters. Recently, VLAO, IWT and Agentschap Economie, in cooperation with F.I.T. have joined forces to form a consortium acting as the Flemish branch of Enterprise Europe Network, offering a wide range of information and other services. In addition, private professional organizations and federations such as VOKA, UNIZO and Agoria also develop activities to support internationalization. F.I.T. has agreements of cooperation with these organizations.

Globalization brings about great opportunities, but also great challenges to all firms. SMEs in particular have difficulties to respond to these changes in the business environment, given their limited resources and other disadvantages linked to the small scale of their operation. Nevertheless, an increasing number of SMEs are internationalizing, either through export, import or other forms of internationalization, and doing so successfully.

Evolutions in communication and transportation technology have substantially reduced barriers to internationalization, enabling small and young firms, with limited resources and limited experience, to pursue a global strategy. As a result, the traditional models of small firm internationalization, which depict the process as an evolution in incremental stages, no longer correspond with the increasing empirical evidence of born global firms, or international new ventures. Especially firms in technology intensive sectors seem to reap the benefits of rapid internationalization. These firms often operate in small niches, and thus need to have operations on a global scale to be profitable.

Although the barriers to internationalization have been reduced in the past two decades, small firms still find it difficult to overcome the barriers that are still in place. In addition, internationalization brings about increasing risk and uncertainty, and not all entrepreneurs are willing to take this risk. When considering internationalization as a strategic option, the entrepreneur has often limited information about conditions in foreign markets. To overcome these obstacles, small firms often rely on the international experience of their network, such as their current buyers and suppliers.

Given their limited resources, SMEs cannot choose from the same set of strategic options available to large firms. While large firms can choose to internalize certain activities, SMEs often have insufficient resources to do so, and thus need to use the market and cope with the transaction costs involved.

An analysis of the external and internal factors should lead to the development of a strategy. Those firms that have the internal capabilities to face the risks and barriers of internationalization and incorporate internationalization in their strategy, still need to bring this strategy into practice. Choosing the right market, the appropriate timing and the optimal entry mode, are just some of the options to successfully implement an international strategy, and ultimately increase a firm's profits. The optimal scope of the international operations will depend on the interaction between the strategic needs of the firm, its resources and environmental factors in both its home market and foreign markets. While high tech firms may choose rapid internationalization and follow the international new venture approach, the stage theory may still be the most appropriate for firms in mature industries. The timing and risks involved in these approaches are different, and firms need to evaluate whether they want to reduce the risk and follow a conservative pattern, or need to capture market share fast before their technology becomes obsolete. The internationalization strategy must fit the firm's overall strategic objectives.

Despite the strategic importance and the possible benefits of internationalization, a large number of SME owners indicate they have never considered internationalization. Many others have considered internationalization as a strategic option for their business, but did not bring this into practice because they could not overcome the barriers associated with internationalization.

The most important internal barriers for SMEs are the costs involved in internationalization and the characteristics of the products or services. Laws and regulations and lack of financing are the main external barriers for SMEs in Europe. While there are no considerable differences in terms of external barriers between Belgian and European SMEs, the product's quality and specifications seem to be much more important for Belgian SMEs than for their European counterparts.

Overall, the percentage of exporting and importing Belgian SMEs is higher than the European average. SMEs in Flanders and Brussels are more internationalized than SMEs in Wallonia. The most common mode of internationalization for Belgian SMEs is the combination of import and export. Export and import are much more common among older and larger SMEs than among young and small SMEs. Still, some recently established firms start exporting shortly after inception. These international new ventures are characterized by extremely high growth rates, and are most common in high technology sectors. In general, SMEs in these high tech sectors are more internationalized than SMEs in other sectors.

Internationalized SMEs report faster growth in employment, value added and labor productivity. Especially in the years directly following foreign market entry, both exporting and importing SMEs experience very high growth rates. Despite the risks involved in internationalization, both import and export have a positive impact on firm survival.

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Table 32 List of NACE-codes

MANUFACTURING (bold: "core" manufacturing)	
10	Mining of coal and lignite; extraction of peat
11	Extraction of crude petroleum and natural gas; service activities incidental to oil and gas extraction, excluding surveying
12	Mining of uranium and thorium ores
13	Mining of metal ores
14	Other mining and quarrying
15	Manufacture of food products and beverages
16	Manufacture of tobacco products
17	Manufacture of textiles
18	Manufacture of wearing apparel; dressing and dyeing of fur
19	Tanning and dressing of leather; manufacture of luggage, handbags, saddlery, harness and footwear
20	Manufacture of wood and of products of wood and cork, except furniture; manufacture of articles of straw and plaiting materials
21	Manufacture of pulp, paper and paper products
22	Publishing, printing and reproduction of recorded media
23	Manufacture of coke, refined petroleum products and nuclear fuel
24	Manufacture of chemicals and chemical products
25	Manufacture of rubber and plastic products
26	Manufacture of other non-metallic mineral products
27	Manufacture of basic metals
28	Manufacture of fabricated metal products, except machinery and equipment
29	Manufacture of machinery and equipment n.e.c.
30	Manufacture of office machinery and computers
31	Manufacture of electrical machinery and apparatus n.e.c.
32	Manufacture of radio, television and communication equipment and apparatus
33	Manufacture of medical, precision and optical instruments, watches and clocks
34	Manufacture of motor vehicles, trailers and semi-trailers
35	Manufacture of other transport equipment
36	Manufacture of furniture; manufacturing n.e.c.
37	Recycling
40	Electricity, gas, steam and hot water supply
41	Collection, purification and distribution of water
45	Construction
SERVICES	
50	Sale, maintenance and repair of motor vehicles and motorcycles; retail sale of automotive fuel
51	Wholesale trade and commission trade, except of motor vehicles and motorcycles
52	Retail trade, except of motor vehicles and motorcycles; repair of personal and household goods
55	Hotels and restaurants
60	Land transport; transport via pipelines
61	Water transport
62	Air transport

63	Supporting and auxiliary transport activities; activities of travel agencies
64	Post and telecommunications
65	Financial intermediation, except insurance and pension funding
66	Insurance and pension funding, except compulsory social security
67	Activities auxiliary to financial intermediation
70	Real estate activities
71	Renting of machinery and equipment without operator and of personal and household goods
72	Computer and related activities
73	Research and development
74	Other business activities

Table 33 Variables influencing degree of control in entry mode choice.

		high control	low control
Global strategic variables			
Global Concentration	High	X	
	Low		X
Global Strategic Motivation	Yes	X	
	No		X
Global Synergy	High	X	
	Low		X
Global Concentration	High	X	
	Low		X
Environmental variables			
Political, economic and sociocultural environment	Favorable	X	
	Non-favorable		X
Cultural and geographical distance	Small	X	
	Great		X
Demand Uncertainty, present and projected size of target market	Low sales potential		X
	High sales potential	X	
Target country production factors	Low production costs	X	
	High production cost		X
Competition intensity	Atomistic		X
	Oligopolistic	X	
Transaction-specific Variables			
Local marketing infrastructure	Poor	X	
	Good		X
Value of firm-specific know-how	High	X	
	Low		X
Tacit nature of know-how	High	X	
	Low		X
Product differentiation	Differentiated		X
	Standard	X	
Pre- and post-purchase service	Service-intensive	X	
	Non-service intensive		X

Source: Sleuwaegen (1997)

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