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Internationalisation of Dutch SMEs

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Internationalisation is part of the current reality of doing business. More and more small and medium-sized enterprises (SMEs) are being confronted with the trend to internationalise. The internationalisation of SMEs has increased for various reasons, for example, technological changes (in the field of communication and transport), deregulation of markets, liberalisation of world trade and the enlargement of the internal market of the European Union. Import is the most frequent international business activity of Dutch SMEs. In 2004 26% of Dutch SMEs indicated importing goods or services from abroad, 18% was involved in exports, 2% invested abroad and 9% cooperated with foreign enterprises. Whereas the Dutch business sector as a whole is among the largest exporters, importers and foreign direct investors, Dutch SMEs, as compared to SMEs from other European countries, occupy a position in the middle with respect to the share of enterprises that export, import or invest abroad. In the coming years an increase in the international involvement of Dutch SMEs is expected. This may involve a focus on new and more countries; an increase in internationalisation for industries that used to be focused on the domestic markets (e.g. business services) and the internationalisation of more business activities (such as production, distribution and R&D) than was the case in the past. SMEs will also have to face new challenges and/or threats. It is essential for SMEs to be able to provide extra added value and to co-operate in (international) networks. The most significant threat will come from (increased) foreign competition.

The globalisation of economic activities may affect SMEs in various ways. For some SMEs entering foreign markets offers opportunities for independent extension and growth of business activities. Large international companies increasingly outsource their activities offering opportunities for SMEs in both industrial sectors and in services. Furthermore, SMEs are increasingly being confronted with foreign competition in the home market.

This report deals with the following subjects:

- Overview of the internationalisation of Dutch SMEs
- The internationalisation of Dutch SMEs from an international perspective
- Trends in internationalisation

The results are based on data from the EIM SME Policy Panel 2004¹, the ENSR Enterprise Survey 2003², expert interviews and a literature review.

Overview of internationalisation of Dutch SMEs

Degree of internationalisation

Table 1 gives an overview of the degree of internationalisation among Dutch SMEs as based on the EIM SME Policy panel 2004. SMEs are defined as enterprises with up to 100 employees.

¹ A panel consisting of approx 2,000 small and medium-sized enterprises that is consulted three times a year about its member's business activities, business performance, policy issues etc.

² This Survey was held as part of the 'Observatory of European SMEs' for the European Commission. See for more information:
http://europa.eu.int/comm/enterprise/enterprise_policy/analysis/observatory_en.htm

table 1 Internationalisation of Dutch SMEs, in percentages, 2004

<i>Mode of internationalisation</i>	<i>% of Dutch SMEs</i>
Export	18
Import	26
Foreign direct investment*	2
International cooperation:	9
Cooperation with foreign enterprises only	2
Cooperation with 'both foreign and Dutch enterprises	7

* Percentage that invested abroad in the past three years.

Source: SME-Policy panel, July 2004.

The most cited international business activity of Dutch SMEs is import (about a quarter). SMEs also comparatively often export goods or services abroad (about one fifth). About one tenth of the enterprises cooperates with foreign business partners. Investment abroad occurs least frequently. A small part of Dutch SMEs (2%) invested abroad in the past three years. Most SMEs combine two or more modes of internationalisation.

Half of the SMEs that invested abroad has established a fully-owned enterprise or subsidiary abroad (see table 2). 37% has a share in a foreign firm and about a quarter is involved in a joint venture.

table 2 FDI by SMEs by type of investments

	<i>% of SMEs that has invested abroad in the past three years</i>
Establishment of own firm/subsidiary abroad	51%
Foreign acquisition	9%
Participation/share in foreign firm	37%
Merger	-
Joint venture with a Dutch or foreign partner	23%
Investments between parent and daughter enterprise	7%
Other	9%

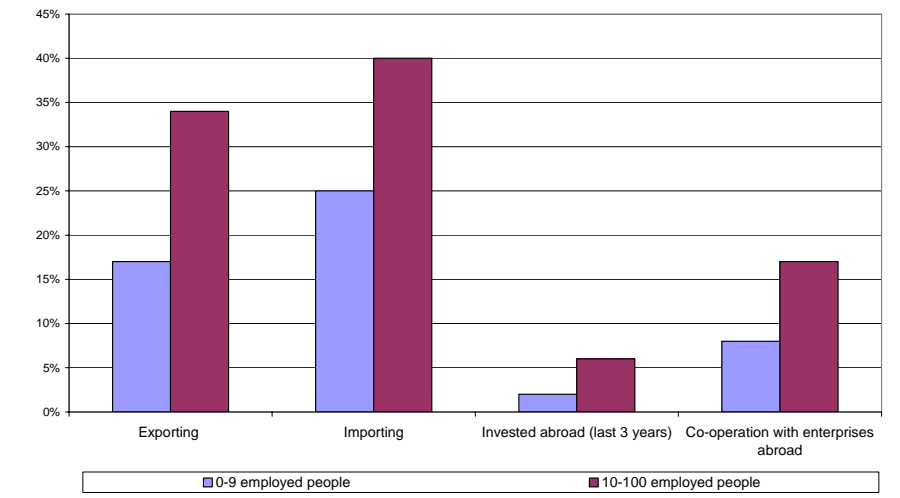
Source: EIM, SME Policy Panel, July 2004.

SMEs invest mainly in a sales organisation abroad (50%). In addition investments in production (35%) and innovation & development (30%) are quite common.

Size class and sector orientation

The degree of internationalisation increases with size class for all modes of internationalisation (see figure 1).

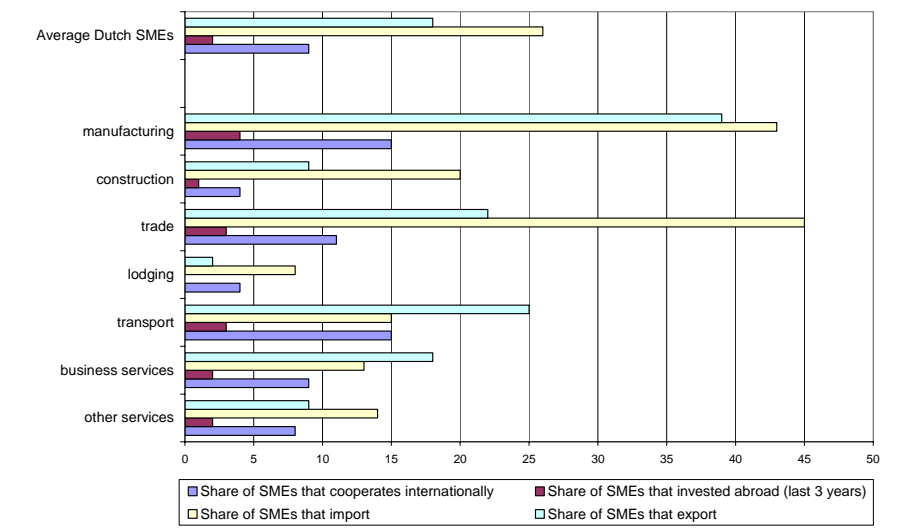
figure 1 Percentage of internationalised SMEs by size class, 2004



Source: EIM SME Policy Panel, July 2004

Figure 2 shows the percentage of internationalised SMEs for each of the industries. Manufacturing, transport and trade have the highest share of exporting SMEs. The share of importing SMEs is highest in trade and manufacturing. As regards foreign direct investments this applies both to the trade and the transport sector. Manufacturing and transport have relatively the highest share of SMEs that co-operate with foreign enterprises. To summarize, the internationalisation of Dutch SMEs takes place mainly in manufacturing, trade and transport.

figure 2 Percentage of internationalised SMEs for each industry, 2004



Source: EIM SME Policy Panel, July 2004.

The distribution of internationalised SMEs across industries provides some other insights (see table 3). For example, it appears that most exporters are proportionally active in trade and services. Half of the importers are active in trade. SMEs that co-operate internationally are especially active in trade and business services. What is especially striking is that a proportional share of SMEs that export or co-operate with foreign enterprises

can be found in the services sector. Foreign direct investors can be found mainly in trade, transport and service oriented industries (see table 4).

table 3 Distribution of internationalised SMEs across industries

	<i>Distribution of exporting SMEs</i>	<i>Distribution of importing SMEs</i>	<i>Distribution of SMEs that cooperate internationally</i>	<i>Distribution of Dutch SMEs</i>
Manufacturing	18	14	14	9
Construction	7	11	5	14
Trade	37	53	37	31
Accommodation	1	2	3	7
Transport	8	3	9	5
Business services	27	14	25	29
Other services	2	3	7	5
Total	100	100	100	100

table 4 Distribution of SMEs that invested abroad (last 3 years) across industries

	<i>Distribution of SMEs that invested abroad (last 3 years)</i>	<i>Distribution of Dutch SMEs</i>
Manufacturing	21	23
Trade & transport	44	36
Services	35	41
Total	100	100

Source: EIM SME Policy Panel, July 2004.

Intensity of internationalisation

Exports form a small share (less than a quarter) of the total turnover of the enterprise in most SMEs. Imports also often have a share of less than a quarter in the total business costs. For the majority of firms with FDI the amount invested abroad is less than 1,000,000 euros but for almost half of the enterprises the invested amount is less than 100,000 euros. No information is available about the intensity of foreign co-operation. However, it is clear that foreign co-operation resulted in an improvement of the competitive position for most of the Dutch SMEs that co-operated with (a) foreign business partner(s) (85%).

Geographical orientation

Dutch SMEs trade mainly with EU-15 countries of which Germany and Belgium are the most important trading partners. When investing abroad SMEs concentrate a little less on the EU-15, but countries in Europe are still by far the most important destination of foreign direct investments. No information is available about the origin of foreign co-operation partners of Dutch SMEs. However, as is the case with the other international activities, this probably mainly involves co-operation with partners in other European countries.

Motives for internationalisation

The limited domestic market in the Netherlands is an important motive for firms to become active on international markets. This is one of the most cited motives for all modes of internationalisation. Access to know-how and technology is also one of the commonly cited motives for export, import and international co-operation. Higher production costs in the domestic market are an important reason to import or to invest abroad and other specific motives for international co-operation include the provision of a broader assortment and the possibility to reduce costs by means of co-operation.

Barriers

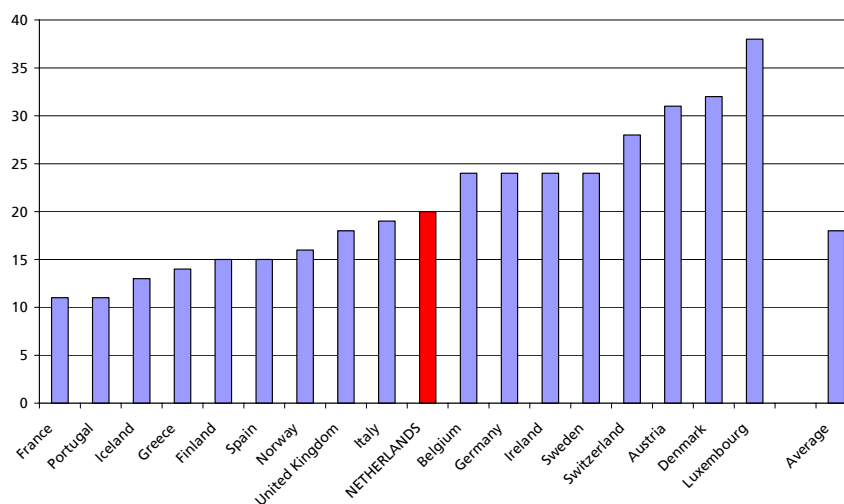
Firms encounter various barriers when conducting international business activities. The major barriers for SMEs in the export process are high costs, legislation and regulation, the price of products/services and language and cultural differences. SMEs that import are less often faced with barriers and when this does happen this involves mainly the price of products or services. When investing abroad firms most commonly have to overcome obstacles such as lack of knowledge and skills within their own firm and also language and cultural differences. The most important obstacles in the way of co-operation with foreign firms are limitations which are the consequences of taxation and regulation, language and cultural differences. Another specific barrier that enterprises have to deal with when co-operating with foreign firms is the wish to retain their independence and an unwillingness to share sensitive information.

Internationalisation of Dutch SMEs from an international perspective

The ENSR Enterprise Survey 2003 contains data on the internationalisation activities of SMEs in a large number of European countries. This Survey was held as part of the 'Observatory of European SMEs'. In this Survey SMEs are defined according to the European definition, i.e. firms with fewer than 250 employees.

In figure 3 it is apparent that the share of exporting SMEs is a little above the average for all countries. Luxembourg has the largest share of exporting SMEs but Denmark, Austria and Switzerland also have a relatively high share of exporting SMEs. The countries with the highest shares of exporting SMEs are usually small countries. The small scale of the domestic market is often an important reason to look for foreign market expansion.

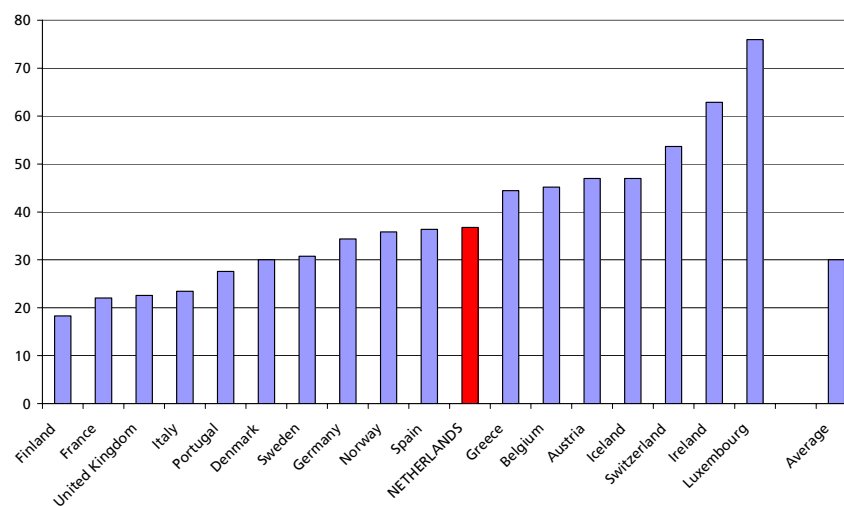
figure 3 Percentage of SMEs with exports, 2003



Source: EIM, based on ENSR Enterprise Survey 2003.

The percentage of Dutch SMEs with a foreign supplier is slightly above average (see figure 4). Luxembourg, Ireland and Switzerland have the largest share of SMEs with imports.

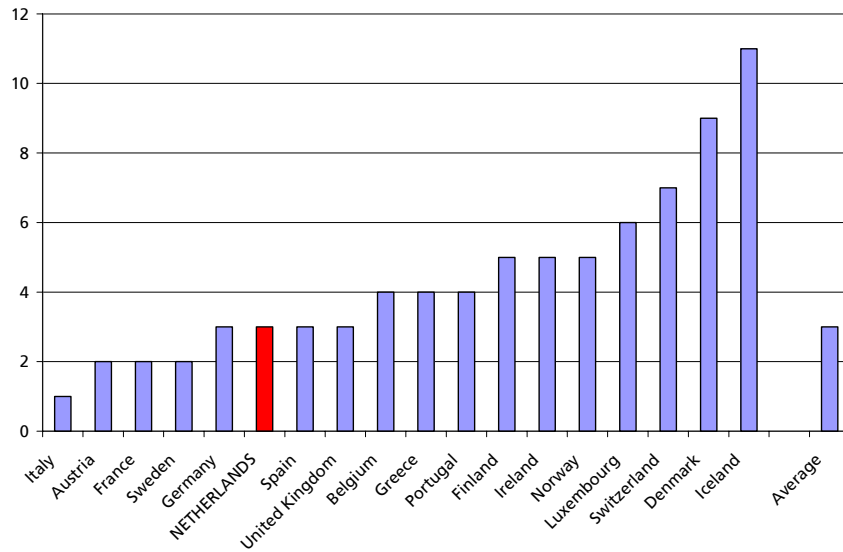
figure 4 Percentage of SMEs with imports/foreign supplier



Source: EIM, based on ENSR Enterprise Survey 2003.

The ENSR Enterprise Survey 2003 indicates that 3% of Dutch SMEs have subsidiaries, branches and/or joint ventures located abroad (see figure 5). This is comparable with the average for all countries. Iceland, Denmark and Switzerland have the highest share of SMEs with foreign investments.

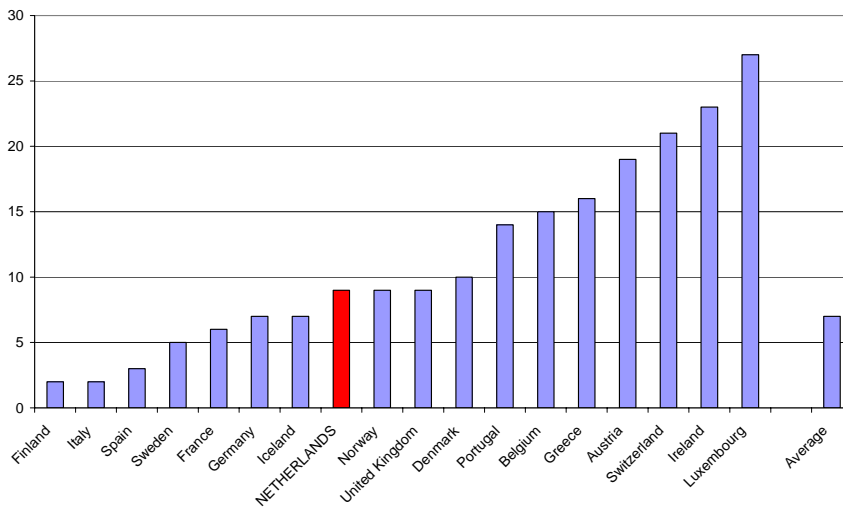
figure 5 Percentage of SMEs with foreign direct investments



Source: EIM, based on ENSR Enterprise Survey 2003.

The results of the ENSR Enterprise Survey reveal that 31% of Dutch SMEs are formally co-operating. This is above the average of 25% for all countries. It appears that 9% of Dutch SMEs indicate that their most important co-operation partner is/are foreign SMEs (see figure 6). The average for all countries is 7%.

figure 6 Percentage of SMEs with a foreign SME as most important co-operation partner



Source: EIM, based on ENSR Enterprise Survey 2003.

The Dutch business sector as a whole is among the largest exporters, importers and foreign direct investors in the world. This paragraph has shown, however, that the Dutch SME sector does not take such a leading role. With respect to the number of SMEs that export, import or invest abroad, Dutch SMEs have a position in the middle compared to SMEs from other European countries.

Trends in internationalisation and research agenda

Trends: extension of SME-internationalisation

Primarily an increase or extension of SME-internationalisation is expected in the coming years. This may require an increase in the involvement of SMEs in international business activities as SMEs increasingly need to have to internationalise e.g., will have to out-source or participate in joint ventures in order to be able to sell their products and to remain or become competitive. Developments within the EU, such as the diminishing of trade barriers, have resulted in the emergence of a wider competitive market. It is clear that the formal integration process of the EU has created a powerful impulse, for example, a growing number of Dutch SMEs expect to do business with new EU Member States.¹ So it is expected that SMEs will widen their country orientation significantly, compared to the current situation. To a great extent the trade and investment of Dutch SMEs is focused on nearby countries, especially the neighbouring countries. However, it is expected that, as a result of developments, such as increased globalisation and further European integration, SMEs' country orientation will be more wide ranging. In past years considerable attention has been paid to the enlargement of the European Union and the opportunities that this provides for business. Recent results show that SMEs, in particular, see opportunities to increase their exports to the new EU Member States.² There also seems to be an increasing number of enterprises that intend to invest in Central and Eastern Europe, these are mainly enterprises in manufacturing and construction.

Some SMEs are already looking outside the new EU-countries for business opportunities, e.g. in the Ukraine, Romania and Turkey and, interest in markets outside Europe, such as China and India is increasing. It is argued that these markets provide opportunities for expansion for Dutch firms, especially because large markets are involved (in terms of population).³

However, although it is clear that distant markets will offer opportunities for SMEs that are active in niches, it will still remain particularly difficult for SMEs to gain a permanent place in these distant markets. Larger firms have more financial leverage to undertake activities in more difficult countries and to remain active and competitive in these markets.

¹ Brummelkamp, Guido and Jolanda Hessels (2004), *Kansen in de nieuwe EU-lidstaten. De betekenis van de uitbreiding van de Europese Unie voor het Nederlandse MKB (Opportunities in new EU Member States. The meaning of the enlargement of the European Union for Dutch SMEs)*, EIM, Zoetermeer.

² Brummelkamp, Guido and Jolanda Hessels (2004), *Kansen in de nieuwe EU-lidstaten. De betekenis van de uitbreiding van de Europese Unie voor het Nederlandse MKB (Opportunities in new EU Member States. The meaning of the enlargement of the European Union for Dutch SMEs)*, EIM, Zoetermeer.

³ Wetenschappelijke Raad voor het Regeringsbeleid (Netherlands Scientific Council for Government Policy) (2003), *Nederland Handelsland. Het perspectief van de transactiekosten (The Netherlands as a trading nation)*, Den Haag.

Extended internationalisation is also expected by industries that usually had a strong focus on the domestic market, such as business services.¹ In the coming years there will, for example, be many opportunities for fiscal experts and auditors in new EU Member States. Technological developments and globalisation have made the export of services easier.

Finally, the internationalisation of SMEs not only concerns foreign purchases and sales, but will increasingly involve a multitude of activities such as production, distribution and R&D. When a firm invests abroad, this may result in a relocation of all business activities. The relocation of production could possibly result in the relocation of R&D, as it is rational to conduct R&D close to the factories where people are involved in production. Ideas for new products or renewal of products often originate on the shop floor.

Trends: challenges and threats for SMEs

SMEs have to meet a number of specific challenges and/or threats. The primary challenge for SMEs is to provide extra added value, in order to be able to increase the margins. There are many opportunities for SMEs on the international market, in specific product-market combinations or niches. One visible development is that SMEs try to retain the uniqueness of their products, for example by developing new concepts in association with the customer, which implies that product and marketing innovations are introduced.

Another challenge for SMEs is to participate more in international networks. The WRR, the Netherlands Scientific Council for Government Policy, hammers on the importance of international trade networks in order to be able to retain importance as a trading nation. Networks are essential for SMEs; networks of subcontractors, consumers and colleagues for example. Various organisations, such as FENEDEX, NEC and the regional chambers of commerce play a role in this field. Trade missions can be very helpful in getting people involved in networking.

The greatest threat to SMEs seems to be the changing competitive environment. Both enterprises that are active on foreign markets and those that focus only on the domestic market will have to deal, more and more, with foreign competition.² These enterprises will, therefore, have to commit, for example, to either cost reductions or entering new markets. The expansion of the EU has led to the entry of many new players. New EU countries can offer products similar in quality to those of the Netherlands. This is bad news for the labour-intensive production in the Netherlands, meaning that labour costs will have to be reduced or part of the production transferred to low-wage countries if the Netherlands is to retain its market share.

¹ See e.g. Wetenschappelijke Raad voor het Regeringsbeleid (Netherlands Scientific Council for Government Policy) (2003), *Nederland Handelsland. Het perspectief van de transactiekosten (The Netherlands as a trading nation)*, Den Haag; Ministerie van Economische Zaken (Ministry of Economic Affairs) (2005), *Visie op verplaatsing. Aard, omvang en effecten van verplaatsing van bedrijfsactiviteiten naar het buitenland (Vision on relocation. Type, extent and effects of relocation of business activities abroad)*, Den Haag.

² Wetenschappelijke Raad voor het Regeringsbeleid (Netherlands Scientific Council for Government Policy) (2003), *Nederland Handelsland. Het perspectief van de transactiekosten (The Netherlands as a trading nation)*, Den Haag.

Trends: developments in internationalisation research

In international research increased attention is being paid to the link between inward (e.g. imports) and outward modes of internationalisation (e.g. exports, FDI). Traditionally, internationalisation research was strongly focused on exports.¹ A number of recent studies emphasize the possible link between inward and outward internationalisation² but research has indicated that a majority of firms is involved in both inward and outward modes of internationalisation.³ It is increasingly recognized that inward and outward modes are interrelated processes, for example foreign purchases may stimulate enterprises to start exporting.⁴ The idea is that the step to start exporting may be easier when a firm already has business contacts in a foreign country.

Another development that has become apparent in internationalisation research is the increase in born globals. Globalisation has made it possible for firms to internationalise immediately after the start of the firm. Such firms are referred to as born globals.⁵ Such abrupt internationalisation differs from the usually gradual process of increased involvement in international markets. It is recognized that the number of born globals in the Netherlands is increasing. This process may involve people that already have international experience, e.g. from a job with a multinational and have decided to start their own business. It has also increased attention for the role and competences of people, including those of the entrepreneur who makes an early start with the internationalisation of a venture/young company.

¹ See e.g. Bloodgood, J.M., H.J. Sapienza and J.G. Almeida (1996), 'The internationalization of new high-potential U.S. ventures: antecedents and outcomes', *Entrepreneurship Theory and Practice*, 20, 4, 61-76; McDougall, P.P. and B.M. Oviatt (1996), 'New venture internationalization, strategic change, and performance: a follow-up study', *Journal of Business Venturing*, 11, 34-40.

² See e.g. Welch, L.S. and R.K. Luostarinen (1993), 'Inward and Outward Connections in Internationalization', *Journal of International Marketing*, 1,1, 46-58; Korhonen, H. (1999), *Inward-Outward Internationalization of Small and Medium Enterprises*, Helsinki: Helsinki School of Economics and Business Administration; Liang, N. and A. Parkhe (1997), 'Importer Behavior: The Neglected Counterpart of International Exchange', *Journal of International Business Studies*, 28, 3, 495-530.

³ Fletcher, R. (2001), 'A holistic approach to internationalisation', *International Business Review*, 10, 25-49.

⁴ Korhonen, H. (1999), *Inward-Outward Internationalization of Small and Medium Enterprises*, Helsinki: Helsinki School of Economics and Business Administration; Overweel, M.J. and C.C. van de Graaff (2002), *Het belang van importeren voor het MKB (The importance of import for SMEs)*. EIM, Zoetermeer.

⁵ Buckley, P.J., J. Campos, H. Mirza and E. White (eds.) (1997), *International Technology Transfer by Small and Medium Sized Enterprises*, London.