



Organization of Islamic Cooperation

EXPORT COMPETITIVENESS OF SMEs : BARRIERS, AND LEVERS FOR IMPROVEMENT



Islamic Centre for Development of Trade
2012

**COMPETITIVENESS OF SMES EXPORT - BARRIERS AND LEVERS FOR
IMPROVEMENT: SUMMARY
BY BRAHIM ALLALI, PH.D.**

SMEs are the most prevalent type of business in all countries with percentages varying between 90 and 99% depending on the definition used. In addition to this prevalence, SMEs are also known for other virtues of which job creation, local development, innovation, etc... However, when looking at the percentage of SMEs' participation in the export effort, we realize it is often below 10%. Striving to increase the engagement of SMEs in export, governments of all countries implement a package of measures including tax and financial incentives. Nevertheless, it is clear that in most developing countries including many OIC Countries, these measures are far from being fruitful. What are the reasons for the inadequacy of such measures? What are the barriers that prevent SMEs from becoming more involved in foreign markets? How to enable these SMEs to overcome these barriers and improve their international competitiveness? These are some of the questions we attempt to address in this document.

Definition and characteristics of SMEs

At the outset, it is necessary to note the absence of a universal definition of SMEs. Each country or each relevant government department in the same country tends to give its own definition of what it means by SMEs in the context of its programs and projects. It is not uncommon to find more than one definition of an SME in the same department following the objectives and stakes of the day. This lack of a universally and commonly accepted definition makes comparisons of SMEs in different countries an arduous and unreliable undertaking. Nevertheless, it is clear that the number of employees and sometimes the volume of annual sales remain by far the two most frequently used criteria in administrative definitions of SMEs.

Given the absence of a universal definition of SMEs, the efforts of both researchers and policy makers interested in this category of companies focused on their characteristics. Nevertheless, the tendency to qualify them as opposed to large companies is unfortunately too prevalent. This is probably what explains why most programs meant to help these companies do not give the expected results. Contrary to an assumption founding most of these support programs to SMEs, these are far from being smaller versions of larger companies. In other words, the tools and techniques in place to help them start from the implicit assumption that they will react like larger companies. Don't we say that "who can do more can do less"? So, if these measures have proved to be effective in the context of large enterprises, they should, logically, be relevant and even more relevant for SMEs. However, reality teaches us that nothing is far from the truth. Indeed, SMEs have characteristics that make them as different from larger enterprises as caterpillars are different from butterflies.

The management books on SMEs abound on the characteristics of this type of businesses. However, it is clear that these characteristics are not common to all SMEs and no SME is like any other. Also, is it more important to understand the logic of these companies than trying in vain to establish a composite sketch as many researchers and policymakers seem to do.

In short, what distinguishes the two species, thus preventing SMEs to be miniaturized versions of large enterprises; it is the centrality of the manager of the SME as opposed to his colleague of the large business. Torres, a famous author in the field of SME management, even compares the leader of the SME to the pilot of an aircraft and the senior executive of a large business to an air traffic controller. So while the first in his cockpit, effectively pilots the plane, the second, in the control tower, merely gives instructions. This does not mean that the role of the latter is less important than the role of the first one, but these are two different roles, which should be distinguished in order to understand the logic of SMEs.

This centrality of the leader of the SMEs that some call egotrophy, is behind most of the characteristics of SMEs. Beyond their diversity, these can be reduced to a mix of proximities: hierarchical, functional, market, marketing, temporal, financial, etc.

Hierarchical proximity means that all employees of SMEs are directly related to the owner-manager who is the sole supervisor. Functional proximity, in turn, means that the level of specialization of both the manager and his employees is very low and that everyone within the SME can perform multiple tasks due to the relatively low volume of activity that does not justify the specialization in a single function. The proximity of the market means that the SME often deals with the immediate geographic market before turning to more remote ones. For its part, proximity marketing refers to direct contact with customers that the manager often knows personally. This proximity is frequently the basis of the competitive advantage of most SMEs. This is particularly important for an SME in the process of internationalization, it is often necessary to think first to build a competitive advantage independent of proximity marketing or physically locate on the foreign market in order to try to reproduce the same conditions of competitive success than on the local market.

The temporal proximity in the context of SMEs means that the short term is often privileged in comparison with to the long term. It ensues that the strategy of most SMEs is informal, intuitive and short-term oriented. Finally, the financial proximity refers to the tendency of most SMEs to resort to alternative financing methods such as informal financing or family tontine systems when such systems exist before resorting to the banking system.

Of course, the smaller the SME the more these characteristics tend to be met. On the other hand, the more it tends to grow the more they begin to fade out to be gradually replaced by the buds of the features of larger firms.

The knowledge of these characteristics allows us to better understand how to help SMEs if we want to improve their international competitiveness. For example, it would be vain to put in place measures to promote exports if they fail to help SMEs build the foundations of a new competitive advantage, non-dependent on proximity to customers. Similarly, the introduction of new financing would not help much if one does not include alternative channels of financing often used by SMEs.

Internationalization of SMEs

There is no consensus even on the notion of internationalization. Many definitions indeed coexist in the literature and are sometimes full of meanings, which are broad enough to cover similar but different concepts, such as globalization, etc., or close enough to be confined to a particular form of internationalization such as exports.

In short, we consider that an SME is international as long as it operates and conducts business with customers located in a foreign country regardless of whether these activities take a physical form - such as selling goods to a foreign customer - or virtual - as in the case of a software application or song downloaded by a foreign client against payment -.

According to the way it follows, internationalization can be inward or outward. Inward internationalization essentially consists of imports and the different strategies of cooperation with foreign firms in the local market. Contrarily, outward internationalization brings the company outside its local market in different forms: exports, investments, etc.. It is especially this type of outward internationalization that is discussed in this document.

There is no doubt however that a company, especially when small or medium sized, will be faced, upon entering a foreign market - and therefore unfamiliar - with a set of difficulties and barriers that it must understand in order to cope with them. We summarize the most important ones later in this work.

Internationalization Strategies of SMEs

SMEs' managers can adopt different strategies for internationalization. They can go in a progressive manner, as they can become international from their inception. Besides these two main strategies, there are a myriad of ways to become international some of which are in their infancy phase.

Internationalization by steps

Many studies show that internationalization by steps is the most frequently adopted internationalization strategy by SMEs. Indeed, many managers prefer to test the waters before becoming more involved in internationalization following an incremental process allowing a more gradual learning. In general, one can identify the main phases in this process:

- ✓ local sales;
- ✓ indirect export;
- ✓ direct export;
- ✓ Physical presence in the foreign market.

Internationalization at the inception

This is a relatively recent internationalization strategy for SMEs. Indeed, as these are increasingly found in industries where products are relatively standardized and where domestic demand is comparatively insufficient; many SMEs are designed as early as at their inception to meet more or less homogeneous needs in different countries. This is particularly and not exclusively the case of technological SMEs. This is true also and especially of SMEs located in countries where the domestic market is too narrow to allow them to achieve economies of scale and optimize the management of their potential. These are small countries - in terms of population - which are most integrated into international trade. Thus, per capita exports of a small country like Singapore are higher by more than 17 times than those of the United States. Moreover, they represent more than twice the national gross domestic product of Singapore, which shows the importance of transit movement of goods by this small country almost totally dependent on foreign trade. Therefore, it is not difficult to imagine that companies in Singapore - such as those of Luxembourg and Belgium - often have no choice but to become international at their inception, while U.S. or French companies feel less pressure to leave their home market; the latter being sufficiently large and promising to incite domestic firms to focus on it often on an exclusive basis.

We note, however that, sometimes, the population of the country of location does not correspond to that targeted by the company. Indeed, French or American companies might feel the same pressure to internationalize as the Belgian or Luxembourgian companies if their products or services are intended for a specific audience scattered in several countries. In a context of large companies, it is difficult to imagine, indeed, a company like Boeing seeking to sell only to Americans or Renault focusing only on the French market.

Virtual Internationalization

The advent of the knowledge economy and progress in new information technology and communication, revealed a previously unknown form of internationalization, namely the virtual or the cyber-internationalization. It means that a small business will sell its products on its Web site and deliver them virtually. We therefore, exclude

from this form of internationalization, the use of transactional sites only to sell physical products. We include only the sale of dematerialized products likely to be downloaded by the buyer located in a foreign country such as computer applications, songs and e-books and magazines.

This form of internationalization is becoming common in some industries such as publishing, music, software sales, etc., where it is possible to download the purchased (dematerialized) product and pay in a secured way without physical contact with the seller and without passage of goods across the border.

Passive or Spontaneous Internationalization

Under this form, no decision to internationalize the company is taken. There are times when simply to continue as usual, gives a de facto international character to the SMEs. This is the case with the two Sudan or the former Czechoslovakia. In contrast, the reunification of the two countries can neutralize the international status of some companies as in the example of the two former Yemen or the two ex German countries (FRG and GDR).

Other internationalization strategies

Of course there are other strategies that SMEs sometimes use to become international, but which, remain relatively rare given the fact that they require a particular codified know-how that most SMEs do not have. These include out-licensing and leasing patents, as well as out-franchising.

In the light of the foregoing, it appears that, given the characteristics of most SMEs based on a mix of proximity, the adventure of these companies beyond their domestic market seems to be like swimming against the stream. Indeed, competitive advantage often depends on their proximity to customers so they can not benefit from them overseas. On the other hand, the mode of operation and organization in general is a highly local fashion focusing on the centrality of the manager and his/her involvement in all activities and tasks of the business. But doing business abroad requires an international approach allowing a perfect and quick adaptation to the requirements of foreign markets. We will see later in this document that in addition to these inherent weaknesses, the internationalization of SMEs is often hampered by barriers and other obstacles that must be identified in order to find the proper remedies. Does this mean that the effort to help SMEs to internationalize is doomed to failure in advance? The answer to this question can only be negative. However, instead of striving to develop programs of fiscal and financial incentives just to find out later that SMEs have not at all increased their international commitment, it would be more appropriate to help them adapt their structures. Such an adaptation aims to make them comply with the requirements of international activity and more easily overcome the barriers that prevent them from doing so.

SMEs facing barriers and obstacles to export.

With regard to barriers and in addition to those inside the company and arising from the weakness of its resources and expertise, the SME is also confronted with difficulties arising from its business environment both locally and internationally. Several typologies are used in the literature to categorize these barriers and difficulties. One of them states that SMEs going international, face the following liabilities : liability of foreignness, liability of newness, i.e. unknown and without reputation in the foreign market. However, in several countries, customers only buy brands they know well, and finally, the liability of smallness, which here stands for the limited resources to invest in building an image and in the consolidation of market knowledge.

In recent studies on international trade, it is customary to use a type known as the Classification of MNT.

First, this typology uses jargon different from others in that it talks about non-tariff measures (NTMs) and procedural obstacles (POs) rather than barriers or handicaps. NTM can be defined generally as "policy measures other than tariffs, which potentially can have an economic effect on international trade of goods, by changing the quantity traded, the price of goods, or both ". The term NTM is a neutral concept that must be distinguished from the term frequently used of non-tariff barriers (NTBs). This implies that there is a negative effect on trade. The Multi-Agency Team and Support Group of Eminent Persons on Non-Tariff Barriers view that NTBs represent a class of MNT with a «protectionist or discriminatory goal."

NTMs are usually specific to the importing country that applies them. In fact, exporting SMEs in developing countries are more affected by these NTMs at import level in foreign countries because their exports are considered in these countries as imports.

The classification of NTMs was prepared by a group of technical experts from eight international organizations, including FAO, IMF, ITC, OECD, UNCTAD, UNIDO, World Bank and WTO. This classification is the basis for the collection, classification, analysis and dissemination of information on non-tariff measures from official sources (example, government regulations) as well as for data based on the perception of commercial actors (Example, the business surveys).

The classification of NTMs distinguishes 16 chapters and is built on the basis of the old coding of trade control system of UNCTAD, which was modified and expanded by new categories of measures to reflect current market conditions. The current classification of NTMs was finalized in November 2009.

As for procedural barriers (POs), they are related to compliance with the NTMs or the business environment and infrastructure inefficiencies that hamper export development. POs in the classification used by international organizations, there are nine classes of stumbling blocks that summarize all the procedural difficulties that importers and exporters face.

Thus, using this typology, a recent study by the ITC in two OIC Member Countries, namely Burkina Faso and Morocco, reveals that exporting SMEs face NTMs and POs in foreign markets and in their own countries as well.

The survey on NTMs in Burkina Faso revealed that three out of five companies surveyed (60%) are affected by NTMs in their export and / or import activity. These measures affect most industries covered by the survey and exporting companies are much more affected than importing firms.

Measures affecting exporters are applied by both foreign partner countries (79%) and by Burkina Faso (21%). Nearly 70% of cases of measures applied by the partner countries include the conformity assessment. These are primarily requirements for certification, inspection, and, to a lesser extent, in the testing. As for the measures applied by Burkina Faso to exporting companies, they are mainly related to the issuing of certificates prior to export and the payment of taxes and charges on exports that companies consider too high.

Companies also face several types of procedural obstacles that occur mainly in Burkina Faso (52%), but also in partner countries (43%). These barriers focus on the delay of administrative procedures, fees and charges unusually high and the excessive number of documents required.

Regarding the survey in Morocco, it reveals in a summary way that the agricultural and agro-food companies complain especially about technical regulations and, to a lesser extent, about conformity assessment and measures at export level.

Textiles and clothing Exporting firms are more bothered by the export measures. We recall that this category includes measures applied by the government of the exporting country (Morocco in this case) on exported goods. It refers to measures with which exports must comply. These include quotas or export bans, among others.

Exporting firms of other manufactured goods complain, depending on the product exported, about rules of origin, export measures, and to a lesser extent about the conformity assessment.

Now that we have examined all the main barriers, measures and barriers that exporting SMEs are facing, we will try to identify certain actions that would not only overcome, or at least mitigate these barriers, but also form effective levers to improve the international competitiveness of these SMEs.

Some levers for improving the export competitiveness of SMEs

Knowing that SMEs lack, almost by definition, all kinds of resources, we postulate in our recommendations herein that any public action to improve the competitiveness of each individual SME would bring very little results. Improving the international competitiveness of SMEs in the OIC Member Countries inevitably passes through actions aimed partly at making the business climate in these countries conducive to exporting SMEs and, secondly, to promote emergence of practices and forms of collaboration within the SME population.

Improving the business climate to foster the competitiveness of SMEs

Actions to improve the business climate to make it conducive to exporting SMEs can take two main forms: the removal or mitigation of institutional barriers and export barriers on the one hand, and the implementation of mechanisms of supervision and support to exporting SMEs on the other.

The first form can be achieved through a series of actions including:

- ✓ Organization by the various entities intervening in the export process of initiation workshops to procedures or techniques of which they are in charge.
- ✓ Other entities may also organize training sessions according to their respective fields.
- ✓ Publication and distribution of guides intended for exporters to explain, in a simple and illustrated manner, the different procedures.
- ✓ The barriers applied by countries can be summed up in the three following barriers: High number of documents required to clear goods from customs services, the exceptionally high cost incurred and finally, the delay in carrying out administrative procedures. It is clear that these are precisely the three main criteria considered by the authors of *Doing Business in ...* published by the World Bank to classify the different countries in relation

with the trading Across Borders dimension. It is therefore quite possible in this regard to improve the ranking of countries in relation to this issue while eliminating or at least reducing the impact of these barriers on exporting SMEs.

- ✓ The electronic exchange of information between the entities involved in the export process is one example of ways to reduce both the time needed to clear goods from customs, the costs involved and the number of required documents.
- ✓ We also propose physical or virtual single windows, in the main regions of each member country to carry out the export procedures.
- ✓ Many SMEs also complain about the absence in their respective countries of laboratories accredited by the authorities of importing countries. In this regard, we propose to the authorities in charge of foreign trade in member countries to negotiate mutual agreements with their major trading partners to recognize tests and analyzes to avoid to their exporters the need of having to incur additional costs for further testing abroad.

The second form, the implementation of support mechanisms and the coaching of exporting SMEs, can be implemented through conventional measures to encourage exports. These measures are found in all countries whether these measures are fiscal, financial, or logistical, etc... So no need to hark back to these general measures found in all national and international reports to promote exporting companies. However, two institutional measures seem particularly important, which we may quote in this respect given both their originality and their proven effectiveness in improving the competitiveness of exporting SMEs: First, the modulation of various incentives both at the industry and the regional levels and then the search for more integration and complementary value chains of exporting companies.

- ✓ Regional and industry modulation of incentives and support structures: the grouping of businesses of all sizes on a regional basis and depending on synergy effects they are likely to establish with each other constitutes a very effective way of improving their competitiveness.
- ✓ Looking for more integration of value chains of exporting SMEs: in relation to the previous recommendation, the grouping of companies must be based on the search for the possible integration of their value chains. However, in addition to input suppliers and processors of these inputs, which are the primary activities of the combination, as well as research laboratories, stakeholders involved in the exporting process, such as customs and freight forwarders which form the support activities, it will be necessary to also promote the establishment of businesses trading internationally. We believe that these companies, because of their mastery of foreign trade procedures, can play a leading role in boosting the exports of SMEs of the grouping, especially as there is in several OIC Member countries a long tradition of bartering.

Collaborative exporting

Collaborative exporting incites SME managers to expand into foreign markets. There are many forms of collaborative exporting. Those presented below are the best known.

- ✓ Clusters (clusters) export-oriented;
- ✓ Joint Action Group;
- ✓ Export Industrial District;
- ✓ Export Consortium;
- ✓ Export management company;
- ✓ Carriage Agreement or Piggy-backing

There are other forms that can be used to facilitate the international expansion of SMEs. However, we have decided to ignore them in this work either because they are only marginally relevant in the context of small SMEs, such as the licensing and the creation of joint venture or because they take the form of local sale without any possibility of learning and knowledge transfer for the benefit of SMEs like sales to international trading companies that buy local SME products for export. We also ignored the use of local sales, a form that is highly successful in Europe and in other countries, because it is an individual export although it is indirect. Indeed, as often practiced, this form involves a collaborative inter-firm collaboration, which is very limited and often does not allow a small business to benefit from knowledge transfer and to optimize its international learning.

Conclusion

The above developments suggest that if the incentives and measures put in place in many developing countries provide little or no positive results in increasing the engagement of SMEs in the international market; it is because they omit to take into account the fundamental characteristics of these SMEs. Indeed, we often consider wrongly these companies as small versions of larger enterprises and, accordingly, we apply to them the same incentives provided to these firms. However, the structures and characteristics of these SMEs differ drastically from large companies and call to rethink the whole export incentive arsenal.

After reviewing the vast majority of the barriers that SMEs face at the export level, this work suggests a set of levers to improve competitiveness. Most of these are based on the assumption widely verified also in developed countries like Canada and the United States, that to succeed in foreign markets and overcome the liabilities due to the limited resources of any kind, SMEs have a vested interest in entering into collaborative forms of which we outline the most important in this work.

Brahim Allali, Ph.D.

Professor at HEC Montreal and International Affairs Consultant