BRIEFING

Requested by the INTA committee

European Parliament

Challenges and concerns for small and medium-sized enterprises (SMEs) doing business in third countries

Policy Department for External Relations
Directorate General for External Policies of the Union
PE 653.629 – March 2021

EN

European Parliament

BRIEFING

Challenges and concerns for small and medium-sized enterprises (SMEs) doing business in third countries

ABSTRACT

This briefing discusses the main challenges and concerns for SMEs doing business in third countries. First, we show the current situation of European SMEs with respect to internationalisation and highlight the corresponding benefits. Second, based on previous literature on the topic, we distinguish between SMEs without international operations and SMEs that are already internationalised and discuss how different barriers can affect them.

EP/EXPO/INTA/FWC/2019-01/LOT5/3/C/07

March 2021 – PE 653.629

EN

This paper was requested by the European Parliament's Committee on International Trade.

English-language manuscript was completed on 8 Marc 2021.

Printed in Belgium.

Author(s): Nazareno BRAITO (VVA), Davide CECCANTI (VVA), and Duy HUYNH-OLESEN (VVA)

Officials Responsible: Mario DAMEN, Wolfgang IGLER

Editorial Assistant: Balázs REISS

Feedback is welcome. Please write to: wolfgang.igler@europarl.europa.eu

To obtain copies, please send a request to: poldep-expo@europarl.europa.eu

This paper will be published on the European Parliament's online database, 'Think tank'.

ISBN: 978-92-846-7896-9 (pdf)
doi: 10.2861/19217 (pdf)
Catalogue number: QA-02-21-310-EN-N (pdf)

ISBN: 978-92-846-7897-6 (paper)
doi: 10.2861/072454 (paper)
Catalogue number: QA-02-21-310-EN-C (paper)

Table of contents

List of abbreviations

ASEAN	Association of South East Asian Nations
B2B	Business to Business
BAIA	Bulgarian Export Insurance Agency
C2C	Cluster to Cluster
CLASS	Custom Local Area Signalling Services
CN	Combined Nomenclature
COSME	Competitiveness of Enterprises and Small and Medium-Size Enterprises
CTEO	Chief Trade Enforcement Officer
E2E	Education to Export
EABC	European ASEAN Business Centre
EBTC	European Business and Technology Centre
ECCP	European Chamber of Commerce
ECICS	European Customs Inventory of Chemical Substances
ECJ	European Court of Justice
EU	European Union
EUREKA	Exceptional, Unconventional Research Enabling Knowledge Acceleration
FTA	Free Trade Agreement
GASEA	New German Accelerator in Singapore
GIN	Global Incubator Network
GSP	Generalised System of Preferences
HS	Harmonized System
MFN	Most Favoured Nation
OCT	Overseas Countries and Territories
OECD	Organisation for Economic Co-operation and Development
PM	Prime Minister
PUR	Preference Utilisation Rate
R&D	Research & Development
SBA	Small Business Act for Europe
SME	Small and Medium Enterprises
TARIC	Tarif Intégré Communautaire; Integrated Tariff of the European Communities
UNCTAD	United Nations Conference on Trade and Development
VAT	Value Added Tax
WCO	World Customs Organization
WTO	World Trade Organization

1 Introduction

For many companies gaining access to international markets is a way to increase competitiveness and foster further development. Internationalisation is considered to be beneficial as it allows companies to increase their technological capabilities by gathering knowledge from abroad, while providing access to cheaper inputs. It also allows companies to exploit specific assets in foreign markets, accumulate global market power and reach an international scale. Furthermore, it lowers their volatility through geographical diversification and provides experience on how to successfully operate in foreign markets by improving organisational capabilities (Contractor, 2007).

Today, internationalisation is important for all companies, large and small. Increasingly, small- and medium-size enterprises (SMEs) are confronted with international competition and are thus required to play a role in international markets (Onkelinx and Sleuwaegen, 2008). In addition, empirical evidence of SME internationalisation emphasises that the benefits of globalisation are no longer exclusively reaped by large multinational corporations, but smaller companies are now benefitting more and more from a global marketplace and the tremendous opportunity for business growth and development (Hutchinson et al., 2009). However, capitalising on the opportunities provided by internationalisation poses significant organisational challenges, especially for SMEs (Hsu et al., 2013).

Irrespective of their size, companies can become international in different ways. These include exporting, contractual arrangements, licensing and franchising, joint ventures, strategic alliances and fully owned foreign direct investment (FDI), including greenfield investments and mergers and acquisitions (Malhotra et al., 2003). Due to SMEs having fewer resources at their disposal, exporting and importing remain the most common means of internationalisation – a finding confirmed by a European Commission survey (2015).

How many European SMEs are currently international in their operations?

Across the 27 Member States of the European Union, more than 25 million SMEs employ around 100m people and contribute half of the bloc's GDP. A recent survey shows that just over a quarter (26 %) of all European SMEs have exported their goods or services in 2019 (European Commission, 2020 a). Specifically, the survey showed that 23 % exported to other EU Member States, 9 % exported to European countries outside the EU, 4 % exported to North America, 4 % exported to the Middle East and Africa, 3 % to Latin America and the Caribbean, 3 % to China and 4 % to the rest of Asia and the Pacific. Interestingly, this trend appears to be rather stable over time. Indeed, another survey conducted in 2009 provided a similar picture, with 25 % of SMEs within the EU exporting (European Commission, 2011).

The data thus indicate that the large majority of European SMEs are not yet profiting from a global marketplace and this situation has not substantially changed over the past decade. The existing gap in global markets participation by SMEs appears even more clear, if we look at the corresponding share of large companies that export their products. The survey found that slightly more than a half (56 %) of large companies were involved in exporting activities in 2019, more than double the proportion of SMEs (European Commission, 2020 a).

Are European SMEs taking full advantage of the opportunities offered by international markets?

The European Central Bank (2019) indicates that exporting SMEs tend to be more profitable and innovative than non-exporting ones. In addition, exporting SMEs are also more likely to be listed on stock markets. In addition to the identification of differences between exporting and non-exporting SMEs, the survey also highlights significant differences within the group of exporting SMEs related to the type of the destination market for these companies. In particular, the survey indicates that those SMEs exporting to markets outside the EU are even more innovative than those exporting only within the EU.

Internationalisation provides advantages to SMEs as it enlarges the market for their products. However, it can also increase the risk of failure for these small, still-vulnerable companies that attempt to enter unfamiliar and highly competitive markets (Mudambi and Zahra, 2007). Nonetheless, empirical evidence suggests that internationalisation can help SMEs extend beyond the limits of domestic markets, capitalise on market imperfections in other countries and achieve greater production volume (Lu and Beamish, 2001). But it has been shown that when SMEs expand internationally, they often experience an initial decline in profitability (Lu and Beamish, 2001; Mudambi and Zahra 2007).

Once the initial obstacles are overcome, increased levels of internationalisation are associated with higher performance, especially for SMEs operating in high-growth, global industries (Mudambi and Zahra 2007). This effect is magnified during an economic crisis, when companies can exploit their operations in foreign markets to succeed and further develop their competitive advantage (European Central Bank, 2015). Moreover, it has also been shown that despite the increased liabilities of newness and smallness, internationalisation overall provides opportunities that increase the chance of survival in the long run (Lee et al., 2012). Indeed, by gaining access to international markets, SMEs can become less vulnerable to country-specific shocks through geographical diversification (Contractor, 2007). As recently underlined by the recent Covid-19 outbreak, SMEs may also benefit from diversifying their supply chains and not being dependent on one single country or region (Business Europe, 2020).

Overview of impediments that can discourage SMEs to internationalise their operations:

As they attempt to internationalise their operations, SMEs are often confronted with substantial barriers which can be defined as “any attitudinal, structural, operative or other obstacles that hinder or inhibit companies from taking the decision to start, develop or maintain international activity” (Leonidou, 1995). These barriers can be both internal and external to the company (OECD, 2006). They are classified as internal if they pertain to the individual company and are generally associated with a lack of organisational capabilities or resources that prevents the company from internationalising its operations. On the other hand, they are classified as external if they stem from the home and/or foreign environment within which the company operates.

It is important to acknowledge that the effects of internationalisation barriers and their relevance vary according to the stage of internationalisation of the company (Alvarez, 2004). Indeed, while for those SMEs that already have international operations, some barriers may have the effect of hampering international growth, but for those SMEs that are not yet internationalised, some barriers may even discourage them from engaging in it. Moreover, while many internationalisation barriers affect SMEs regardless of their stage of internationalisation, it has been shown that certain barriers can be more problematic for SMEs that are not yet internationalised while certain other barriers tend to affect more internationalised SMEs (OECD, 2006). Table 1 shows the type of barriers that SMEs face depending on whether they are present in third countries. While internal barriers relate to the same areas for both those SMEs already internationalised and those not yet, the nature of the barriers is very different.

Table 1: Barriers and challenges of internationalising SMEs

	Internal	External
Not yet internationalised	Information Human resources Financial Marketing	Competitor Procedural Governmental
Already internationalised	Information Human resources Financial Marketing	Procedural Trade (Tariff and non-tariff)

Source: Own elaboration based on literature review

In the following section, we will thus first discuss the barriers (both internal and external) that are likely to affect SMEs that are not yet internationalised. Then, we will discuss the barriers (both internal and external) that are more likely to affect SMEs that are already internationalised. This distinction would allow policy-makers to define more targeted policies according to the type of SME. In other words, if the goal of policy-makers is to increase the number of SMEs that operate in international markets, the focus should be directed to the elimination or at least the reduction of the effects of certain barriers. However, if the goal of policy-makers is to sustain SMEs that already operate in international markets, the focus should be directed to the elimination or at least the reduction of the effects of other barriers (OECD, 2006).

2 Barriers for SMEs that are not yet internationalised

Internal Barriers

Informational barriers:

Among the different types of internal barriers, informational barriers may prevent SMEs from internationalising their operations. Informational barriers can be defined as 'the problems in identifying, selecting, and contacting international markets due to information inefficiencies'[1]. For those SMEs that have not yet started the process of internationalising their operations, these barriers may even dissuade them from engaging in international activity (Wasowska, 2016). The OECD identified several key reasons for informational barriers occurring. First, informational barriers may arise from limited information to locate and analyse markets, which increases the difficulty in finding those national and international sources of information that are available to reduce the amount of uncertainty associated with foreign markets (OECD, 2009). Second, informational barriers may arise from the lack of reliable data about the international market which can be due to problems associated with the source, quality and comparability of available information used to attempt to increase understanding of foreign markets (OECD, 2009). Finally, informational barriers may arise from strategically and/or proactively identifying and selecting opportunities in foreign markets (including customers, contacts, business partners and joint ventures) (OECD, 2009).

Human resource barriers:

Another important barrier to internationalisation for SMEs concerns the difficulties associated with the management of human resources (Mendy and Rahman, 2019). Managers of SMEs that have not yet internationalised their operations may face time and resource constraints for the identification of foreign markets and for the designing of an appropriate entry strategy. Similarly, the increased amount of work demanded by international operations may become overwhelming especially if an SME's personnel have no prior experience in handling the required documentation, the logistical arrangements, and the communication with foreign customers (OECD, 2009). At the same time, SMEs often do not have the same resources for training employees as larger companies. A recent survey indicates that the availability of skilled staff or experienced managers remains the most serious problem for a quarter of EU SMEs (European Central Bank, 2019).

Financial barriers:

Financial barriers also represent an important obstacle for SMEs, especially those that are not yet internationalised. A recent survey found that more than a half of non-exporting SMEs report that the financial investment required to become an exporter is too large and it thus discourages them to internationalise (European Commission, 2015). Financial barriers can occur when SMEs have a shortage of funds needed for researching new markets and adapting marketing strategies to international markets.

[1] Glossary for Barriers to SME Access to International Markets:
https://www.oecd.org/cfe/smes/glossaryforbarrierstosmeaccesstointernationalmarkets.htm#Informational_Barriers

Similarly, financial barriers can occur when there is a shortage of funds needed to finance the necessary investments to start international operations. Finally, financial barriers can occur when there is a shortage of funds needed to insure products or assets in foreign markets. As identified by the literature, financial barriers can be particularly relevant to SMEs as they are linked to company size (European Commission, 2011). Indeed, compared to larger companies, SMEs are usually at a disadvantage when seeking to obtain loans from banks due to their lower assets. In 2019, 18 % of EU SMEs did not obtain the full bank loan for which they have applied, and this clearly creates difficulties for SMEs given that bank-based finance accounts for around 90 % of their financing needs (European Commission, 2020 b). However, it is only when SMEs overcome their financial barriers and have access to sufficient capital that they can become competitive globally (Jinjarak and Wignaraja, 2016). The EU should thus prioritise efforts to financially sustain SMEs.

Marketing barriers:

Finally, marketing barriers can prevent SMEs from internationalising their operations, including the company's product, pricing, distribution, logistics, and promotion activities abroad (Leonidou, 2004). SMEs may have to develop new products or adapt existing ones to the needs of specific foreign markets. At the same time, SMEs may also have to modify their pricing formula in order to match competitors' prices. Overall, these changes may reduce the potential for economies of scale associated with exporting and affect overall profitability (Onkelinx and Sleuwaegen, 2008). Similarly, exporting to foreign countries requires the appropriate distribution channels abroad to be defined. Indeed, foreign markets may substantially vary from the home country in the range and quality of services offered to support companies doing business and in the number of layers making up the distribution channels. Moreover, distribution channels in third countries may already be fully appropriated by local companies that have no incentives to accommodate direct competitors (OECD, 2006). Similarly, local distributors may control certain levels of the distribution and raise the costs for new entrants. Another marketing barrier to internationalisation is represented by the difficulties that SMEs may encounter when they must identify reliable foreign partners. These difficulties may occur when SMEs cannot find partners in the third country to help roll out their operations. For example, foreign partners may have different organisational and operational structures that make the partnership difficult or even more problematic, while local potential partners may already be engaged by competitors (OECD, 2006).

External Barriers

Competitor barriers:

While constrained by limited resources, SMEs are likely to be exposed to intense competition in foreign markets, both from incumbent domestic players and large multinational corporations. SMEs may thus be discouraged from entering foreign markets while they will fear that their domestic competitive advantage could be lost overseas due to more complicated and intensive competitive scenarios (OECD, 2009). Moreover, traditional strategies of internationalisation that work for multinational corporations may be ineffective for SMEs. Therefore, SMEs will need to develop their own unique competitive strategy when faced with competition from foreign companies (Onkelinx and Sleuwaegen, 2008). To successfully compete in international markets, SMEs are required to focus on specific, well-defined market niches, in which they can still hold a competitive advantage, and thus deliver higher value to their customers (Onkelinx and Sleuwaegen, 2008).

Procedural barriers:

Another external barrier that can prevent SMEs from internationalising their operations concerns unfamiliarity with the necessary procedures and required paperwork. Indeed, SMEs may have difficulties in understanding and managing the complexity of customs documentation or the bureaucracy associated with export operations due to their more limited resources (Arteaga-Ortiz and Fernández-Ortiz, 2010). This raises compliance costs and may cause delays which can require SMEs to hold larger inventories and working capital (OECD, 2018). Of the barriers to internationalisation, procedural barriers are less direct, and they are often not visible. As a result, they are usually hard to identify and eliminate (OECD, 2006).

Governmental barriers:

SMEs wishing to internationalise their operations are also often confronted with governmental barriers, which can be defined as 'the barriers associated with the action or inaction by the home and foreign government in relation to its indigenous companies and exporters'[2].

Among them, the lack of home government assistance/incentives to participate in global value chains has been identified as a main concern for SMEs, according to a recent survey (European Committee of Regions and EUROCHAMBERS, 2019). Globalisation has greatly increased in recent years, and production is now more and more fragmented across companies and countries. While multinational corporations have been at the forefront of this process, SMEs are increasingly confronted with the opportunities but also the challenges offered by global value chains (OECD, 2018). Participation in global value chains can be extremely beneficial for SMEs as it can provide access to global markets at lower costs, create opportunities to scale up the business and accelerate innovation and managerial know-how (OECD, 2018). At the same time, SMEs' awareness and understanding of the structure and the dynamics of global value chains is generally low, and most SMEs across different sectors are not able to identify their competitive strengths within the value chain (OECD, 2008). Moreover, concerns about both the inadequacy of resources needed and the inability to protect the company's intellectual assets may hinder the opportunities for SMEs to successfully participate in global value chains (OECD, 2018). This suggests that SMEs would benefit from more practical information on the benefits of participating in global value chains and assistance in how to more concretely obtain access to them.

3 Barriers for SMEs that are already internationalised

Internal barriers

Informational barriers (FTAs):

When exporting, companies can use free trade agreement (FTA) schemes to reduce their payment of tariff rates. The number of FTAs has greatly increased since the early 1990s and their role in the world economy has become increasingly crucial. SMEs exporting in other countries can benefit from FTAs as they can have the opportunity to access the foreign market at a lower cost than prior to the implementation of the agreement. Similarly, SMEs that are importing capital goods and/or input from a foreign country also benefit from FTAs as the access to foreign markets provides opportunities to reduce the costs associated with imports. Altogether, this allows stronger connections between companies, generating a flow of new trade opportunities.

The survey from the European Committee of Regions and EUROCHAMBRES indicated that the key challenges for SMEs relate to the complexity and lack of consistency of the rules of origin as well as the high administrative burden to comply with customs procedures and formalities. These results are in line with previous research on the topic that has clearly identified the costs and requirements associated with the utilisation of FTAs as major barriers faced by companies operating in third countries (Songa and Moonb, 2019). Indeed, exporting companies are forced to meet the rules of origin for each product under each FTA, issue the certificate of origin and submit it to the customs authority. To reap all the available benefits associated with FTAs, exporting companies not only have to fully understand the provisions of each FTA and the tariff concession schedules but also to develop a sufficient degree of familiarity with the

[2] Glossary for Barriers to SME Access to International Markets: https://www.oecd.org/cfe/smes/glossaryforbarrierstosmeaccesstointernationalmarkets.htm#Informational_Barriers

procedures required for the issuing of the certificates of origin and the requirements associated with the rules of origin (Wignaraja, 2014).

It is thus not surprising that that larger companies have a comparative advantage over SMEs in the benefits they can get from using FTAs when exporting given their higher financial, physical, and human resources (Takahashi and Urata 2010). Indeed, while FTAs provide lower tariff rates for exporting companies, their utilisation involves some costs, such as the need to change procurement sources from the optimal pattern or general administrative costs. Therefore, it is only beneficial for companies to use FTAs if the gains obtained from lower tariff payments are higher than the increased costs. In addition, the amount of export matters, since the greater the number of exports made, the greater the saving in tariff payment will be (Hayakawa, 2015). This implies that all the costs associated with the utilisation of FTAs are much more relevant for SMEs and, if too high, they may even discourage SMEs from using them. Another important aspect that should be considered is that SMEs have a similar degree of likelihood of FTA use. Indeed, this can be influenced by improving understanding at a company level, which can be achieved, for example, through R&D expenditure and learning by doing as well as by acquiring knowledge on FTAs through interactions with those institutions responsible for the definition of the FTAs (Wignaraja, 2014).

Informational barriers (public procurement):

Public procurement accounted for USD 11 trillion out of a global GDP of nearly USD 90 trillion in 2018 (World Bank, 2020). Thus around 12 % of global GDP is spent following procurement regulation. The EU and its trading partners are continually trying to grant each other more and more access to public procurement for several goods and services to encourage more open and balanced international markets. For SMEs, gaining access to public procurement can be beneficial in several ways: SMEs can be assured that foreign government will engage in fair business practices given the laws, regulations, and trade obligations to which public procurement is subjected (OECD, 2018). At the same time, by becoming a supplier to a government, SMEs can improve their credibility and gain recognition in the foreign market as a reliable partner (OECD, 2018). Despite the potential benefits, SMEs are in fact still underrepresented in public procurement as compared to their overall weight in the economy. Recognising this situation, the EU and many other foreign countries are currently taking steps both to give SMEs better access to public markets and to remove barriers preventing SMEs from winning public contracts. Many of these barriers arise from the specific characteristics of public procurement, such as the complexity of procedures, the amount of paperwork required for applications and the insufficient access to information on business opportunities. Finally, language differences may also represent a barrier for SMEs given that tenders on public procurement are often published in the foreign country language which requires additional investments by SMEs.

Human resource barriers:

Internationalised SMEs need to efficiently run activities in foreign markets and to promptly communicate with foreign customers. To do that, they need to allocate employees in the foreign market to effectively handle these tasks. However, managing employees abroad can pose a big obstacle to the success of the business. One reason relates to the presence of cultural as well as linguistic differences between the SME home country and the foreign country where the SME operates (Arteaga-Ortiz and Fernández-Ortiz, 2010). In the worst case scenario, cultural and linguistic differences may lead to a sense of distrust between the managers of the SMEs located in the home country and the managers as well as the customers located in the foreign country (Roy et al., 2016). This distrust may then lead to compromised relationships which will negatively affect the existing business. A second reason why operating in a foreign country may be challenging for SMEs relates to the constrained mobility of highly skilled personnel. Indeed, although some studies have suggested that physical distance may not play a substantive role in the mobility of highly skilled workers (Cairncross, 1997), more recent evidence has suggested that for a range of reasons, particularly monetary and human (stress) costs, highly skilled workers are constrained in space (Miguelez and Moreno, 2012).

Marketing barriers:

For internationalised SMEs, marketing barriers can arise from difficulties in adjusting promotional activities to foreign markets, difficulties in offering technical and after-sales services, difficulties associated with excessive transportation and insurance costs and difficulties in supplying inventory abroad (OECD, 2006). Difficulties in adjusting promotional activities in foreign markets can occur due to differences between the home and the foreign country in consumption patterns and government regulations, such as variations in the composition of the target audience, inappropriate content of the advertising message, unavailability or different use of advertising media, restrictions in the frequency and duration of advertising, and insufficient means to assess advertising effectiveness across countries (OECD, 2006). Difficulties in offering technical and after-sales services can occur due to problems associated with the provision of technical and/or after-sales service including delays and increased costs associated with, for example, geographical distances between the company and its foreign market, the setting up of service operations in strategic locations, the maintaining of large amounts of spare parts and the adjustment of the approach to after-sales service for third countries (OECD, 2006). Difficulties associated with excessive transportation costs can simply occur because of the large distance involved between the home and the foreign country but also because of a low level of transportation infrastructure in the foreign country. Similarly, with increased distance insurance costs also increase and for SMEs, these costs may be too high especially if they are not spread over large quantities of products. Finally, difficulties in supplying inventory abroad can occur when the SME has successfully internationalised its operations in a foreign country and it is confronted with shortages of products overseas due to transportation delays or demand fluctuations (OECD, 2006). This may result in the inability of the SME to keep track of supplying customers overseas with long term damage to the SMEs' credibility.

Another important marketing barrier for internationalised SMEs is represented by the difficulties of gaining access to new foreign customers and potential partners in order to expand foreign business. In this regard, for internationalised SMEs, the use of business networks to advance their internationalisation process can be particularly beneficial. One example of how business networks can be particularly useful for SMEs relates to the increased opportunities to strengthen contacts with other companies establishing the business relationships that may lead to the entry into global value chains (Measson and Cambell-Hunt, 2013). Indeed, global value chains are usually organised by rules and regulations designed to co-ordinate the activities and the access of each member of the chain, and these can create impediments to SMEs. By enlarging their networks, SMEs can overcome such barriers. In this regard, trade-related initiatives, such as trade fairs, represent a great opportunity to get recognition, interact with other SMEs and collect information that can improve the long-term decision-making process on the opportunities provided by global value chains (Bettis-Outland et al., 2010). However, for SMEs, attending trade-related initiatives can be difficult due to time and resource constraints. Therefore, more governmental support dedicated to trade-related initiatives can be particularly beneficial for SMEs wishing to improve their position in global value chains (Monreal-Pérez & Geldres-Weiss, 2019).

External Barriers

Procedural barriers

For internationalised SMEs, certain procedural barriers may also affect the success of their overseas operations. Among them, SMEs may have difficulties in achieving timely collection of payments from overseas due to the lack of immediate contact with overseas markets or due to foreign buyers requesting more credit facilities (OECD, 2009). At the same time, for SMEs it may be challenging to enforce contracts due to low quality (e.g. non-verifiable information, ambiguity, lack of consideration or mutual acceptance and unreasonable breadth of the contract) or due to unclear expectations, misinterpretation, 'bad faith' and/or unwillingness of contract partner(s) to uphold the contract (OECD, 2009). Finally, it can be difficult for SMEs to resolve disputes because of non-existent or unsophisticated dispute resolution mechanisms, time and/or cost of accessing foreign legal systems, lack of knowledge of foreign laws, and conflicts of laws (OECD, 2009).

Trade barriers (tariff and non-tariff):

Trade barriers still represent a significant obstacle, especially for those SMEs with international operations (OECD, 2006). Trade barriers are the barriers associated with restrictions on exporting and internationalising imposed by governments in foreign markets. Trade barriers can be particularly problematic for SMEs given that these barriers are usually outside their direct control and are difficult to overcome (OECD, 2006). Moreover, while trade barriers do not directly target SMEs, they can be particularly vulnerable to them given that they generally lack economies of scale that help mitigate their impact – i.e. trading costs can represent a higher share of their exports (World Trade Organization, 2016).

Tariff barriers:

High tariff trade barriers can be defined as 'the burden associated with excessive tax applied to imported goods to artificially inflate prices of imports and protect domestic industries from foreign competition'[3]. Reducing tariffs means that SMEs can import raw materials at a lower cost and thus reduce their production costs, allowing them to then increase productivity. Lower tariffs also enables technology to be upgraded more cheaply, which also boosts productivity, lowering costs and increasing competitiveness. An OECD survey clearly indicated that high tariffs are considered to be the most significant trade barrier for SMEs that seek to internationalise their operations (OECD, 2006). Nonetheless, policy-makers in the EU and in third countries have increasingly managed to substantially reduce the burden related to high tariff barriers through FTAs (OECD, 2018). A recent survey found that the highest benefit of FTAs for SMEs is the possibility to benefit from preferential tariffs (European Committee of the Regions and EUROCHAMBERS, 2019). Another key advantage of FTAs is that they do not require periodic renewal, as is the case with partial scope agreements between countries. This offers stability and predictability since the rules for the two countries/regions on tariffs for trading goods and services are not liable to sudden changes. SMEs exporting or importing from a third country under an FTA can thus develop long-term sustainable strategies that can help their financial and budget planning. Finally, FTAs have been shown to facilitate trade in goods and services and investment by providing an environment that is conducive for business between the partner countries. SMEs have therefore more opportunities to sell their products overseas by gaining access to previously closed markets and to import at lower costs.

Non-tariff barriers:

SMEs have also identified as relevant barriers to trade in the survey non-tariff barriers (OECD, 2006). More specifically, the inadequacy of property rights protection, the high costs of customs administration, the presence of restrictive health, safety and technical standards controls have all been identified as signifcant barriers encountered by SMEs. The inadequacy of property rights protection refers to the issues associated with an inadequate legal framework to protect the ownership, use, control, benefit, transfer or sale of both physical and intangible property, especially intellectual property (OECD, 2009). The high costs of customs administration refer to the costs related to different interpretations of customs valuation rules by different customs administrations, the delay in customs clearance procedures, the lack of procedures for prompt review and the lack of transparency (OECD, 2009). Finally, the presence of restrictive health, safety and technical standards refers to the difficulties associated with meeting high, non-transparent, inconsistent

[3] Glossary for Barriers to SME Access to International Markets: https://www.oecd.org/cfe/smes/glossaryforbarrierstosmeaccesstointernationalmarkets.htm#Informational_Barriers

and discriminatory country-specific standards for imported products (OECD, 2009). Empirically, it has been shown that the implementation of non-tariff barriers by a country reduces imports of affected products from targeted exporters by up to 12 % (Kinzius et al., 2019). When looking at the specific types of non-tariff barriers, Kinzius and colleagues (2019) have shown that import controls significantly reduce trade between two countries by 2-8 %, so that imports fall on average by 2-11 % if implemented. This indicates how relevant non-tariff barriers are for the economy in general. Moreover, it is worth noting that while tariff barriers have been lowered over time, non-tariff barriers have become more prominent, both in terms of how they are perceived by companies and in terms of prioritisation in international trade policy discussions (World Trade Organization, 2016). Therefore, additional efforts to harmonise standards and technical regulations should be made to help SMEs and incentivise their participation in the global market. Particular attention to SMEs is justified since non-tariff barriers affect SMEs disproportionately due to fixed compliance costs that do not vary with the amount of traded products and the already mentioned inability of SMEs to spread these compliance costs over large export quantities. One proven solution to reduce the impact of non-tariff barriers is the implementation of FTAs. Indeed, it has been empirically shown that the trade-dampening effect of non-tariff barriers is strongly reduced if the importer and the exporter are operating in countries covered by an FTA (Kinzius, 2019).

References

Articles and papers

Alvarez, R. (2004), *Sources of export success in small- and medium-sized enterprises: the impact of public programs*. International Business Review, 13(3): 383-400.

Arteaga-Ortiz, J., and Fernández-Ortiz, R. (2010), *Why Don't We Use the Same Export Barrier Measurement Scale? An Empirical Analysis in Small and Medium-sized Enterprises,* Journal of Small Business Management, 48(3): 395-420.

Bettis-Outland, H., Cromartie, J. S., Johnston, W. J., & Borders, A. L. (2010), The Return on Trade Show Information (RTSI): A Conceptual Analysis. *Journal of Business & Industrial Marketing*, 25(4): 268-271.

Business Europe (2020), Recommendations on the implementation of EU free-trade agreements.

Cairncross F. (1997), The Death of Distance: How Communications Revolution Will Change Our Lives. London: Orion Business Books.

Contractor, F. J. (2007), *Is International Business Good for Companies? The Evolutionary or Multistage Theory of Internationalization vs. the Transaction Cost Perspective,* International Management Review, 47 (3): 453-475.

European Central Bank (2015), *Assessing European Firms' Exports and Productivity Distributions: The CompNet Trade Module,* ECB Working Paper No. 1788.

European Central Bank (2019), *Export activities of euro area SMEs: insights from the Survey on the Access to Finance of Enterprises (SAFE)*, Economic Bulletin, Issue 8/2019.

European Commission (2011), *Opportunities for the internationalisation of European SMEs* – Final Report.

European Commission (2015), *Internationalisation of European SMEs*.

European Commission (2020 a), *An SME strategy for a sustainable and digital Europe,* consulted at https://ec.europa.eu/info/sites/info/files/communication-sme-strategy-march-2020_en.pdf.

European Commission (2020 b), *Flash Eurobarometer 486: SMEs, start-ups, scale-ups and entrepreneurship*.

European Committee of Regions & EUROCHAMBRES (2019), *Implementation of Free Trade Agreements: Challenges and opportunities for businesses and regions,* Survey Results Note.

Hayakawa, K., (2015), *Does firm size matter in exporting and using FTA schemes?*, The Journal of International Trade & Economic Development, 24(1): 883-905.

Hsu, W. T., Chen, H. L., & Cheng, C. Y. (2013), *Internationalization and firm performance of SMEs: The moderating effects of CEO attributes,* Journal of World Business, 48(1): 1-12.

Hutchinson, K., Fleck, E., & Llyod-Reason, L. (2009), *An investigation into the initial barriers to internationalization: Evidence from small UK retailers,* Journal of Small Business and Enterprise Development, 16(4): 544-586.

Jinjarak, Y., & Wignaraja G. (2016), *An Empirical Assessment of the Export-Financial Constraint Relationship: How Different are Small and Medium Enterprises?,* World Development, 79(1): 152–63.

Kinzius, L., Sandkamp, A., & Yalcin, E. (2019), *Trade protection and the role of non-tariff barriers*, Review of World Economics, 155(1) :603–643.

Lee, H., Kelley, D., Lee, J., & Lee, S. (2012), *SME Survival: The Impact of Internationalization, Technology Resources, and Alliances,* Journal of Small Business Management, 50(1): 1-19.

Leonidou, L. C. (1995), *Empirical Research on Export Barriers: Review, Assessment, and Synthesis,* Journal of International Market, 3(1): 29-43.

Leonidou, L.C. (2004), *An Analysis of the Barriers Hindering Small Business Export Development*, Journal of Small Business Management, 42 (3): 279–302.

Lu, J. W., & Beamish, P. W. (2001), *The internationalization and performance of SMEs,* Strategic Management Journal, 22(6-7): 565-586.

Malhotra, N. K., Agarwal, J. & Ulgado, F. M. (2003), *Internationalization and Entry Modes: A Multi theoretical Framework and Research Propositions,* Journal of International Marketing, 11(4): 1-31.

Measson, N.& Cambell-Hunt, C. (2013), *How SMEs use trade shows to enter global value chains,* Journal of Small Business and Enterprise Development, 22(1): 99-126.

Mendy, J., & Rahman, M. (2019), *Application of human resource management's universal model: An examination of people versus institutions as barriers of internationalisation for SMEs in a small developing country,* Thunderbird International Business Review, 61 (1): 363–374.

Miguelez E., Moreno R. (2012), *What attracts knowledge workers? The role of space, social connections, institutions, jobs and amenities,* Institut de Recerca en Economia Aplicada Regional i Pública-Working Paper.

Monreal-Pérez, J. & Geldres-Weiss, V. V. (2019), *A configurational approach to the impact of trade fairs and trade missions on firm export activity*, Business Research Quarterly. https://doi.org/10.1016/j.brq.2018.11.001.

Mudambi, R. & Zahra, S. (2007), *The survival of international new ventures,* Journal of International Business Studies, 38(1): 333–352.

OECD (2006), *The Role of Trade Barriers in SME Internationalisation*, OECD Trade Policy Papers, No. 45, OECD Publishing, Paris.

OECD (2008), *Enhancing the Role of SMEs in Global Value Chains,* OECD Publishing, Paris.

OECD (2009), *Top Barriers and Drivers to SME Internationalisation*, Report by the OECD Working Party on SMEs and Entrepreneurship, OECD.

OECD (2018), *Fostering greater SME participation in a globally integrated economy*, OECD 2018 Ministerial Conference on SMEs, OECD.

Onkelinx, J. & Sleuwaegen, L. (2008), *Internationalization of SMEs,* Flanders DC.

Roy, A., Sekhar, C. & Vyas, V. (2016), *Barriers to internationalization: a study of small and medium enterprises in India,* Journal of International Entrepreneurship, 14(4): 513-538.

Songa, J.H., & Moonb, H.C. (2019), *Exploring the Intention of FTA Utilization by Exporting SMEs: Evidence from South Korea,* Journal of International Logistics and Trade, 17(1): 1-11.

Takahashi, K., & Urata, S. (2010), *On the use of FTAs by Japanese firms: Further evidence*, Business and Politics, 12 (1): 1-15.

Wasowska, A. (2016), *Perception of Export Barriers at Different Stages of the Internationalization Process – Evidence from European SMEs,* Journal of Entrepreneurship, Management and Innovation, 12(4): 29-50.

Wignaraja, G. (2014), *The determinants of FTA use in Southeast Asia: A firm-level analysis,* Journal of Asian Economics, 35(1): 32-45.

World Bank (2020), *How large is public procurement?,* World Bank Blogs.

World Trade Organization (2016), *Levelling the trading field for SMEs,* World Trade Report, 2016.

PE 653.629
EP/EXPO/INTA/FWC/2019-01/LOT5/3/C/07

Print ISBN 978-92-846-7897-6 | doi: 10.2861/072454 | QA-02-21-310-EN-C
PDF ISBN 978-92-846-7896-9 | doi: 10.2861/19217 | QA-02-21-310-EN-N