

# POLICY BRIEF #2

## European and Australian SME Internationalisation



### EXECUTIVE SUMMARY

‘Small and medium-sized’ (SMEs) enterprises are at the centre of the economic crisis due to the Covid-19 pandemic and its social isolation measures. The current crisis has impacted SMEs disproportionately, and has revealed their susceptibility to the supply and demand shock. In response to this crisis, the European Union (EU) and the Australian Government has adopted policy measures to support SMEs and minimise their financial calamities. The internationalisation of businesses is increasingly important to the survival and overall success of many firms in an increasingly interdependent and globalised

environment. The EU and Australia’s Free Trade Agreement (FTA) negotiating process provides formidable opportunities for SMEs to internationalise. The process of internationalisation enables Australian and European businesses to increase their levels of productivity and profitability while prompting them to innovate their operational systems as they engage more deeply with information communication technologies (ICT). During the process, it is imperative to consider the potential drivers and barriers to the internationalisation of SMEs across both continents and to evaluate the subsequent ramifications it could have for the EU-Australia FTA.

## **INTRODUCTION**

The EU-Australia FTA negotiations provide SMEs with opportunities to internationalise and innovate their business partnerships and cooperation. The internationalisation of enterprises has become essential to the survival and overall success of enterprises. Industry 4.0 technologies offer unprecedented opportunities for the SME sector to enhance its competitiveness at the local, regional, national and international levels (Sommer, 2015). It is revolutionising technological developments in industry, businesses and society resulting in an increase in automation and data exchange in manufacturing technologies and processes such as, Cyber-Physical Systems (CPS), the Internet of Things (IoT), Industrial Internet of Things (IIOT), cloud computing, cognitive computing and Artificial Intelligence (AI) (Schwab, 2017).

These technological developments have rendered internationalisation strategies more accessible to SMEs by providing them with more agile tools for expansion (Lee et al., 2012). The drivers of Industry 4.0 have transformed business models in many industries and in the process, have prompted the removal of physical and geographical barriers (Porter & Heppelmann, 2015). Unlike previously, SMEs are now having to compete alongside multinational enterprises (MNEs) in a rapidly evolving environment where global value chains (GVCs) provide more possibilities for them to compete in international

markets. Whereas MNEs have the resources to expand their activities abroad, research shows that SMEs usually lack the necessary resources and capabilities (Ibid, 2015).

Despite the obvious barriers to SME internationalisation, exporting can contribute to their survival and competitive growth. Studies reveal that the internationalisation of SMEs is a key factor in determining the degree of SME performance in terms of productivity, profitability, innovation and growth. At the same time, the size of the enterprise, innovation and performance have proven to be key determinants of SME internationalisation choices and their success in foreign markets (European Commission, 2020).

## **DRIVERS FOR SME INTERNATIONALISATION**

SMEs are the backbone of national economies and are increasingly becoming integrated into GVCs. They actively contribute to economic growth, the creation of jobs and innovation in both mature and emerging economies (Dominguez & Mayrhofer, 2018). The integration of SMEs into the global economy has prompted them to innovate both in relation to business operational systems and/or their business models. These changes can add value to their products and services while reducing their cost base. Despite their small size and limited resources, many SMEs have decided to engage in

exploring global market opportunities (Ibid, 2018).

The rapid development of ICT has rendered internationalisation strategies more accessible to SMEs. For example, Artificial Intelligence, Internet of Things, and social media have been providing SMEs with more agile tools to expand and internationalise for a decade or more (Anderson, 2011; Lee et al. 2012). The ability of SMEs to extend beyond borders is becoming a determining factor in their level of competitiveness. When SMEs innovate, they experience increased productivity, potential growth and general sustainability (Lecerf, 2019).

## **BARRIERS TO SME INTERNATIONALISATION**

Since the 1970s, prompted by neoliberal tendencies, Western enterprises began expanding part of their business functions beyond their national border (Pegoraro et al., 2020). Over the past four decades, the gradual internationalisation of SMEs has been accompanied by internal and external challenges which have prompted them to evaluate the costs and benefits that are associated with such business transformations.

The internal barriers SMEs are facing are linked to their corporate environment, such as human resources and managerial knowledge, technological innovations, ICT capacity and

business size. For example, inadequate managerial knowledge, including the degree of international experience, foreign language proficiency, scope of vision and market knowledge, are often considered a major barrier to exporting (Garcia-Alvarez de Perea et al., 2019; OECD, 2019).

Research on European SMEs reveal that internal experience and foreign language proficiency are important drivers of internationalisation and a lack of these skills can significantly hinder businesses' willingness and ability to internationalise (Dow & Larimo, 2009; Nakos & Brouthers, 2002). In addition, technological innovation activities are identified as another primary determinant of SME internationalisation. Technological advances particularly regarding ICT capacity, such as the Internet have reduced the costs of exporting and led to new opportunities for SMEs to extend their business into global markets. Internet technology has also been increasingly integrated into market activities (Lohrke et al., 2006).

External constraints to SME internationalisation include: a) governmental barriers that are associated with actions or inaction by the home and foreign government in relation to its own companies and exporters; b) procedural barriers which are associated with the operating aspects of transactions with foreign customers; c) customer ignorance and foreign competition in foreign markets; d) business environment

barriers which are associated with the economic, political-legal and socio-cultural environment of the foreign market(s) within which the company operates or is planning to operate, e) tariff and non-tariff barriers associated with restrictions on exporting and internationalising imposed by government policies and regulations in foreign markets, and not least, the limited scale and reliability of cash flow (Garcia-Alvarez de Perea et al., 2019; Lohrke et al., 2006).

SME's limited capabilities and market presence make it more difficult to access innovative technology, an impediment avoided by setting alliances and collaborations with buyers and suppliers (Ibid, 2019). Finally, the lack of domestic governmental assistance/incentives and unfavourable domestic rules and regulations in general (e.g. cost of starting a business) and export regulations can be significant barriers to internationalise (Leonidou et al., 2007).

While Export Promotion Programmes (EPPS) are provided by governments to help businesses overcome barriers to exporting, the information gap or knowledge-related weaknesses which is regarded as a serious problem for SMEs and a significant contributing factor in their decision or ability to internationalise (Kumar et al., 2012).

## **IMPLICATIONS AND RECOMMENDATIONS**

The current Covid-19 pandemic has revived public discourse on the implications of SME internationalisation. The considerable economic

and financial challenges businesses are facing due to covid-19, has prompted SMEs to rethink their business operating system (BOS) and business model so that they are better adapted to the increasingly unpredictable global environment.

The internationalisation of SMEs is becoming a necessity for enterprises who want to secure and increase their levels of productivity and profitability while being integrated within the GVCs. The challenge remains however, the degree to which businesses are willing to invest in innovating their operational systems depending on the industry.

Technological developments particularly in ICT has, in many instances, facilitated the process of SME internationalisation, while simultaneously exposing differing degrees of internal and external barriers for SMEs in the process. Looking forward post-covid 19, SME 's face numerous opportunities and challenges and it will be a defining moment for Australian and European SMEs especially within the context of the current negotiations for an EU-Australia FTA.

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