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Canadian SMEs and Globalization
Success Factors and Challenges

TRADE, INVESTMENT POLICY AND INTERNATIONAL COOPERATION

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Insights You Can Count On

Canadian SMEs and Globalization: Success Factors and Challenges
by *Kathleen Macmillan*

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Preface

Small and medium-sized enterprises (SMEs) dominate Canada's economy. Canada's future economic success may depend in large part on the ability of small, innovative companies to take advantage of global opportunities. Moreover, the global economic success of larger companies can depend on how well they integrate smaller enterprises into their supply chains. Yet we know relatively little about the way smaller companies are responding to the new challenges and opportunities posed by globalization, including the rapid acceleration of highly specialized trade.

This report from The Conference Board of Canada's International Trade and Investment Centre is a starting point in addressing this gap and framing the Centre's future research in this area. The report marshals the latest available Canadian and global evidence to assess how SMEs are responding to the current global operating environment. It ranks the top risks and challenges SMEs face, including newer challenges arising from the increasing use of global supply chains and the Internet. It also highlights determinants of SME success in global markets, some of which run counter to common wisdom. As well, the report identifies areas—such as services, investment, and the use of imported inputs—that may be critical to SME success but tend to be ignored in most SME research and policy. The findings point to strategies that SMEs, other businesses and business groups, and policy-makers could adopt to improve SMEs' chances of global success.

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1 These organizations do not necessarily endorse the research conclusions of this paper.

Canadian SMEs and Globalization
Success Factors and Challenges

At a Glance

- Reductions in trade barriers, advances in communications technology, the growth of global supply chains, and other changes in the world economy provide an opportunity for all enterprises, regardless of size, to engage in foreign markets.
- Canadian small and medium-sized enterprises (SMEs) are active in world markets, but relatively few firms derive a significant amount of their earnings from foreign sales or export regularly.
- An examination of globally integrated SMEs challenges traditional thinking about what it takes to succeed. Firm age is not a critical determinant, but the international experience of owner-managers is an important factor.
- Large businesses need to find a way to better integrate SMEs into global supply chains by participating in industrial clusters, addressing SME concerns about supply chain integration, and safeguarding SMEs' intellectual assets.
- Government programs might be more successful if, in addition to advising established SMEs how to break into foreign markets, they also focused on the attributes, experience, and objectives of owner-managers of "born global" SMEs.

Opportunities exist for small and medium-sized enterprises (SMEs) to take advantage of recent developments in global markets and become international players in their own right. The flexibility of smaller enterprises makes it possible for them to integrate into global supply chains and play a role in the increased fragmentation of production across geographic boundaries. The sharp rise in services trade, where scale is less critical in determining competitive advantage, and the surge in foreign direct investment also provide a chance for SMEs to compete on a world scale. Especially in knowledge-based endeavours—where ingenuity, speed, and adaptability are crucial—smaller players can find niches in global markets.

With advances in transportation and technology and reductions in trade barriers, any SME, regardless of location or size, can participate in global markets.

Many SMEs resist internationalization because they see it as providing too few opportunities or perceive the risks as too great. Indeed, only a few Canadian SMEs are internationally active, and a considerably smaller proportion regularly engages in foreign markets. Those that have expressed a desire to internationalize have identified a number of obstacles that impede their progress. Among these are difficulties in identifying market opportunities and entry strategies, choosing reliable foreign partners, accessing financing, overcoming trade barriers, and complying with security and authentication requirements.

SMEs operating within global supply chains encounter special problems in integrating with other players in the chain, avoiding too great a reliance on a single customer, and safeguarding their intellectual assets.

Recent business research on globally integrated SMEs challenges some traditional perceptions. Among the conclusions is that firm age is not a definitive predictor of export performance. New firms can be just as successful as established enterprises in foreign markets. Analysis also shows that the best performing foreign exporters and investors are often headed by owner-managers with an international background. The experience and personal attributes of owner-managers are critical factors in determining whether SMEs choose to internationalize and whether they succeed in foreign markets.

Some lessons can be drawn from the experience of SME exporters. One is that innovation can provide a critical advantage in positioning small firms to participate in global value chains and to better compete in international markets generally. There is also some indication that success rates are higher for firms that undertake foreign direct investment in conjunction with exporting, and for firms that export more than one product and export to varied destinations.

Larger businesses and governments can support the internationalization of SMEs in a number of ways. In fact, the international success of larger companies can depend on how well they interact with smaller companies and include them in their value chains. Industrial clusters and networking provide a way for businesses to share ideas, resources, and risk. Through this type of cooperation, larger enterprises can help SMEs overcome some of the biggest obstacles to international participation.

Governments are already active in providing business advice, financial assistance, and other kinds of support to firms seeking to increase their international presence. There might be some scope for encouraging foreign direct investment by SMEs. Governments might also consider shifting some of their emphasis from supporting established firms to encouraging "born global" SMEs. One way of doing so might be to focus government assistance on the specific attributes and objectives of SME owner-managers who have expressed an interest in foreign markets. Finally, reductions in trade barriers, improvements to transportation infrastructure, and cooperation with our trading partners on tax, security, and intellectual property matters are important to all exporters but particularly so to SMEs, since these barriers tend to affect smaller entities disproportionately.

CHAPTER 1

The Global Environment and Canadian SMEs

Chapter Summary

- Technological and communications advances, along with reductions in trade and transportation barriers, mean that all businesses, regardless of size, have an opportunity to participate in the global economy.
- Growth in integrated trade, an increase in foreign direct investment, and rising trade in services are features of the new global economy.
- Indications are that only a small proportion of Canadian SMEs exports goods or services and an even smaller percentage regularly engages in export markets.

Much has been written about the new trade paradigm and the growth of vast global supply chains that connect businesses worldwide. The evolution of technology, advances in transportation, and reductions in trade barriers mean that the potential exists for all businesses, regardless of their location or size, to participate in global markets. To date, most of the attention has focused on the globalization experience of large businesses. There is little information available on the factors that help small and medium-sized enterprises (SMEs) succeed in global markets. The management literature clearly indicates that SMEs are not simply smaller versions of large companies; SMEs exhibit fundamental differences in management style and their interaction with their environment. It follows that their relationship with international markets would be quite different as well.[1]

Globalization is not an option for all SMEs. For those that do participate, however, it brings concrete benefits. Integration with global markets brings advantages in the form of technological know-how and exposure to diverse products and services. The greater competitive pressure that comes from participating in export markets can spur productivity and innovation. Access to a larger market leads to expanded sales, which can help firms achieve economies of scale and reduce unit costs.

With the evolution of technology, advances in transportation, and reductions in trade barriers, all businesses have the potential to participate in global markets.

SMEs constitute a larger proportion of the economy in Canada than in the United States and most of our other trading partners. SMEs account for roughly 43 per cent of our gross domestic product (GDP) and 62 per cent of our private sector employment. It is therefore critically important to our national productivity and economic well-being that Canadian SMEs achieve their full potential in terms of growth and export performance.

1 Kennedy and Wright, "Overview of the Canadian Presence in Southeast Asia," p. 11.

The internationalization of SMEs is not an issue simply for these firms. The drive to reduce costs by outsourcing or off-sourcing encourages bigger global players to seek affiliations with smaller producers or suppliers. The export success of larger companies can depend on how well they integrate smaller enterprises into their value chains. Larger firms need to understand the operations and motivations of smaller enterprises if they are both to succeed in international markets. Governments and business organizations may be able to facilitate these critical interactions.

THE GLOBAL CONTEXT

The primary trends characterizing the new international paradigm are growth in integrated trade or global supply chains, an increase in foreign direct investment (FDI), and rising trade in services. They have all had a profound effect on SMEs in Canada.

Companies no longer have to do it all but can specialize in the activities they do best and allocate other functions to companies located elsewhere.

While global supply chains are not a new phenomenon, new information, process, and communication technologies—along with reductions in international trade barriers—have made it far easier to move goods back and forth across borders in a semi-finished state. Manufacturing has become more geographically fragmented as producers contract out activities to contain costs. The result is that companies no longer have to do it all but can specialize in the activities they do best and allocate other functions to companies located elsewhere. In 2003, according to the Organisation for Economic Co-operation and Development (OECD), 54 per cent of the world's manufactured imports were considered intermediate goods.[2] In 2006, Canada sold about 28 per cent of its trade as inputs into global supply chains, and 41 per cent of its trade related to parts for its own supply chains.[3]

2 OECD, *Moving Up the Value Chain*, p. 6.

3 Goldfarb and Chu, *Stuck in Neutral.*

Trade is now an integral component of an increasingly complex global production and distribution system. It has evolved from being merely a sales tool to become a tool of production.[4] Technological changes have improved flexibility and increased the relative competitiveness of smaller operations, which makes it possible for small firms to be viable participants in international markets. Importantly for Canada, as a relatively high-cost manufacturing nation, supply chains offer a chance to maintain competitiveness. Producers contract out high-cost assembly or fabricating jobs to foreign operations while performing higher return tasks in Canada, such as marketing and design.

The change in global production patterns was made possible by massive increases in FDI. In Canada, a huge expansion of inward and outward FDI began in the late 1990s as supply chains rose in importance. Outward FDI grew from 15 per cent of GDP in 1990 to nearly 38 per cent in 2002.[5] As evidence of Canada's FDI outflows, sales from Canadian foreign affiliates in 2007 were roughly C$400 billion, which is about on par with direct exports of goods from Canada.[6] Services sales by Canadian foreign affiliates were worth three times as much as Canada's services exports in 2001, reflecting the increased on-site delivery of Canadian managerial, technical, and financial services to foreign customers.[7] The importance of FDI is further reinforced by Goldfarb and Thériault's estimate that, in 2005, sales by Asian-located affiliates of Canadian companies were worth half the total value of traditional services exports to that region and two-thirds the total value of traditional goods exports. In comparison, sales of Asian affiliates located in Canada were estimated to be worth five times the value of traditional services imports and two-thirds the value of traditional goods imports.[8]

At the same time, the Canadian economy has become increasingly services-oriented, with services now accounting for 45 per cent of Canadian GDP. Among the factors

4 Poloz, "Adapting to the New Trade Paradigm."

5 Hodgson, "Integrative Trade and the Canadian Experience," p. 3.

6 Poloz, *Financial Intermediation and the New Trade Paradigm.*

7 Hodgson, "Integrative Trade and the Canadian Experience."

8 Goldfarb and Thériault, *Canada's "Missing" Trade with Asia*, pp. 19–20.

driving this change are advances in information and communications technology that make it possible to produce and deliver services in different locations. Although most world trade is in goods, international trade in services has grown more rapidly in recent years. The emergence of services trade is significant for two reasons: services both facilitate globalization and are affected by it.

THE EXPERIENCE OF CANADIAN SMEs

Most firms in Canada fall into the small or medium-sized categories. Industry Canada defines small firms as those having fewer than 100 employees; medium-sized firms as having between 100 and 499 employees; and large firms as employing 500 or more people. According to information compiled by Statistics Canada's Business Register, firms with fewer than 100 employees make up 97 per cent of establishments in the goods-producing sector and 98 per cent of establishments in the services-producing sector. Of the 2.3 million employer business establishments surveyed in December 2006, 75 per cent had fewer than 10 employees and 58 per cent had between 1 and 4 employees.[9]

In terms of benchmarking, one notable difference between SMEs in Canada and those in the United States relates to industry distribution. Firms with fewer than 250 employees account for three-quarters of manufacturing jobs in Canada, compared with only two-thirds in the United States.[10]

Until very recently, the availability of data seriously limited our understanding of SMEs and global markets. In 2001, Statistics Canada began collecting export registry data by size of exporting enterprise. Previously, available data pertained to "small exporters," which may or may not have been small firms. Indeed, there is reason to believe that the data understated the actual exports made by smaller enterprises.[11] Recent cross-sector analysis comparing the experience and attributes of SME exporters and non-exporters in Canada has advanced our understanding considerably. There remains, however, a lack of good data on the profitability and success of SMEs engaged in international markets.

There are still many areas that are not well understood. For example, the data do not capture services exports particularly well—due, in part, to the nature of services themselves. Statistics Canada data on exports by firm size pertain only to merchandise exports, although they do track goods exports made by firms in the services industry. Services export statistics are based on 3,000 surveys of large firms and no surveys of small enterprises. There is reason to believe that small and medium-sized enterprises account for a disproportionate share of services sector exports. For example, Statistics Canada data suggest that 67 per cent of exports made by micro firms in Canada come from enterprises in the finance and insurance industries. Indications are that many originate in Alberta and are likely associated with exports from the oil and gas sector.[12]

We do not have a complete picture of how Canadian SMEs engage globally—including the degree to which SMEs trade in services or invest globally.

Still another data issue relates to the treatment of intra-firm trade. It has been estimated that over half of U.S. imports from China and one-third of its exports to China are accounted for by foreign affiliates of U.S. firms.[13] Official data therefore give a misleading picture of overall trade balances. A recent Conference Board of Canada report concludes that Canada's trade with Asia is significantly underestimated because of a failure to account for inter-firm links, trade in semi-finished products, and trade in services.[14]

There is little concrete information available on other ways in which Canadian SMEs engage with the global marketplace. For example, figures are not collected on

9 Industry Canada, "How Many Businesses Are There in Canada?"

10 CFIB et al., *The Path to Prosperity*, p. 7.

11 Halabisky et al., *Small Business Exporters*, p. 13.

12 Ibid., p. 20.

13 OECD, *Moving Up the Value Chain*, p. 10, and Poloz, *Financial Intermediation and the New Trade Paradigm*.

14 Goldfarb and Thériault, *Canada's "Missing" Trade with Asia*.

the foreign investments SMEs make. Nor do we know much about the import activity of SMEs, which makes it very difficult to get a handle on supply chain activity. In general, firms are understandably reluctant to provide information about their outsourcing decisions or their arrangements with foreign affiliates. According to Goldfarb and Beckman, indications are that Canadian companies are not seizing the opportunity provided by global supply chains and have limited involvement in them.[15]

Industry Canada's Profile of Small Business Exporters reports that of Canada's 35,594 exporting enterprises in 2002, 84 per cent were small businesses and 13 per cent were medium-sized businesses. Data for 2004 indicate that 8 per cent of Canadian SMEs exported goods or services.[16] According to data collected by Statistics Canada, small businesses accounted for 20 per cent of the value of exports in Canada in 2002, while medium-sized firms contributed 15 per cent of total export value. As the size of firms increases, the percentage of firms reporting export activity also increases. Less than 1 per cent of firms with fewer than 20 employees reported exports.[17]

It is interesting to compare Canadian SME export performance with that of the United States. Canadian small firms export more, on average, than similar-sized firms in the United States, although the percentage of small firms reporting exports is roughly the same in the two countries.[18]

According to Statistics Canada data, 35 per cent of small business exports in Canada in 2001 originated in Ontario, followed by 31 per cent in Alberta. Alberta accounted for 74 per cent of the value of exports from Canadian micro firms—companies with fewer than 20 employees—many of which were from enterprises in the oil and gas sector.[19] Quebec accounted for 22 per cent of the number of small firm exporters in Canada in 2005.[20]

15 Goldfarb and Beckman, *Canada's Changing Role in Global Supply Chains*.

16 Orser et al., *Canadian SME Exporters*, p. 15.

17 Halabisky et al., *Small Business Exporters*, p. 9.

18 Ibid., p. 27.

19 Ibid., p. 15.

20 Statistics Canada, *A Profile of Canadian Exporters*.

Regarding industry patterns, almost 60 per cent of goods exported by Canadian small businesses in 2002 came from enterprises in the services industry. Services enterprises are generally less likely to export than are firms in the manufacturing sector, although professional services-based firms show export propensities similar to those of manufacturing SMEs.[21] However, services SMEs are considerably more numerous than manufacturing SMEs and therefore account for a greater proportion of overall SME export sales.

While an increasing number of Canadian SMEs operate globally, only a few regularly derive a significant amount of their revenues from foreign sales.

While most exports are destined for U.S. markets, there is some indication that small businesses might export to a more diverse group of countries than larger businesses do. For example, the percentage of export sales made to Japan and South America is higher for small firms than for large firms. This difference might be attributable to the fact that smaller exporters are better able to penetrate markets where scale is less important than it is when supplying larger and more established markets, such as the United States.[22]

Survey data provide an interesting picture of the interactions between Canadian SMEs and international markets. A 2004 survey of 9,577 small business owners conducted by the Canadian Federation of Independent Business (CFIB) found that 51 per cent of Canadian SMEs engaged in some form of trade: 36 per cent through importing or exporting, and 15 per cent by participating as part of a global supply chain.[23]

The CFIB survey also confirmed that trade participation grows with firm size. According to the survey results, only 34 per cent of firms with fewer than 5 employees were engaged in some form of trade, compared with

21 Orser et al., *Canadian SME Exporters*, p. 34.

22 Halabisky et al., *Small Business Exporters*, p. 25.

23 CFIB, *Report on Trade*, p. 2.

62 per cent of medium-sized firms with 100 to 499 employees.[24] Firms with more than 50 employees were also more likely than smaller firms to report trading regularly rather than occasionally.[25]

Regarding regional and industrial patterns, SMEs in Ontario, Quebec, Alberta, and British Columbia were more likely to be involved in exporting and importing. Businesses in the wholesale trade and manufacturing sectors were more inclined to be active exporters and importers. SMEs in the agri-business, communications, and transportation sectors also reported high trade involvement.[26]

Finally, research has shown that many Canadian SMEs export only sporadically. The smaller the enterprise, the less likely it is to be a regular exporter.[27]

In summary, while indications are that more and more Canadian SMEs are operating in foreign markets, only a few SMEs regularly derive a significant amount of their revenues from foreign sales. It is also clear that our understanding of how small firms interact with international markets is incomplete because of a lack of comprehensive statistics.

OUTLINE OF THIS REPORT

The next chapter of this report looks at the business challenges SMEs face when they attempt to integrate into international markets. These challenges range from difficulties obtaining market intelligence and financing to complex issues arising from the power imbalances facing small players in large global supply chains. Chapter 3 considers some of the characteristics of SMEs that have performed well in the global marketplace. Chapter 4 sets out business strategies that SMEs could adopt to improve their performance in international markets. Chapter 5 examines the kinds of support that business organizations and policy-makers might provide. Chapter 6 outlines conclusions.

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24 Ibid.

25 Ibid., p. 4

26 Ibid., p. 4.

27 Statistics Canada, *A Profile of Canadian Exporters*, p. 14.

CHAPTER 2

The Challenges and Risks SMEs Face in Accessing Global Markets

Chapter Summary

- Internationalization is not an option for many SMEs, because their product or service is not exportable or they consider the risks too great.
- SMEs that are interested in accessing global markets list several obstacles to doing so, including the challenges of identifying market opportunities and reliable business partners and problems obtaining financing.
- SMEs engaged in global value chains cite the following difficulties: maintaining supply chain relationships; complying with quality control, security, and authentication requirements; and protecting their intellectual assets.

Globalization poses a great many challenges to small enterprises. By definition, SMEs have limited resources, and it is important that they apply their scarce resources to activities that will garner the most success. The risks and costs associated with internationalization are too high for many small firms. It follows that many SMEs have good reason to concentrate on domestic markets and forego foreign opportunities.

It is important to identify barriers to internationalization that might prevent SMEs from pursuing this strategy, particularly those that are genuinely interested in internationalization and that are likely to succeed in international markets. Among the barriers to internationalization that SMEs have identified are the difficulties of identifying export or foreign investment opportunities; verifying the reliability of potential partners, suppliers, and buyers; assessing the capital needed for upfront research and development (R&D); meeting the demands of supply chain partners; and financing accounts receivable.

Many SMEs focus on the domestic market believing there are enough opportunities in Canada or there is insufficient demand in foreign markets for what they sell.

SURVEY RESULTS

A number of recent surveys have focused on the attitudes of Canadian SMEs to international markets and on what SMEs view to be the greatest barriers to more active involvement. The general picture that emerges is that a great many SMEs are content to focus on the domestic market, either because they feel there are enough opportunities in Canada to satisfy their business objectives or because they believe there is insufficient demand in foreign markets for the services or products they sell. For example, a 2007 survey of 637 Canadian small and medium-sized businesses commissioned by United Parcel Service (UPS) indicated that while Canadian SMEs tended to view international business favourably, they were hesitant to enter global markets. The most common reason, given by 37 per cent of respondents, is that they already had enough business in Canada. A further 17 per cent said they needed to grow their business before entering global markets.[1] In its 2003 survey, the CFIB asked non-trading SMEs why they did not trade. A large number (70 per cent) cited market reasons (e.g., their products or services were "not exportable," markets were too small).

While SMEs also cite more concrete obstacles—such as financial needs, tariffs, and intellectual property matters—survey results clearly suggest that the most common barrier is at least partially attitudinal. Risk assessments, psychological obstacles, and managerial objectives are important in explaining the decision of SMEs to internationalize. The apparent reluctance to internationalize (as captured by the surveys) could be due to some combination of a number of factors, including the following:

- The product or service offered is not exportable.
- The firm perceives foreign markets as too risky.
- The firm does not feel it has the skill set or resource capability to internationalize.
- The firm is not interested in expanding its customer base because of a desire to stay small and keep its operations manageable.

Regarding the last point, Crick and Spence have observed that internationalization can put a high personal strain on owner-managers of small businesses and that the desire to maintain a manageable lifestyle can deter them from pursuing foreign opportunities.[2] Larger companies have more resources than smaller companies and can therefore spread the burden over more individuals. Recent Canadian research supports the connection between growth aspirations and export activity. Orser et al. report that owners of SME export firms in Canada are more than twice as likely to indicate a desire to grow their firms as owners of non-exporting enterprises.[3]

The UPS survey indicated several other common barriers to global expansion: finding trustworthy suppliers and distributors (10 per cent); complex trade barriers (8 per cent); tax structures (7 per cent); and lack of familiarity with foreign contracting processes (7 per cent). Only a small number of those surveyed considered corruption (2 per cent) or protection of intellectual property to be major barriers.[4]

Among trading SMEs, the CFIB survey identified global financial risk, regulatory and non-tariff barriers, and border infrastructure as the critical obstacles to international trade.[5]

Internationalization can put a huge personal strain on owner-managers of small businesses and deter them from pursuing foreign opportunities. Larger companies have more resources and can spread the burden.

While somewhat out of date and therefore possibly not reflective of the post-9/11 situation, a 2002 Ipsos Reid survey commissioned by the CFIB, Canadian Manufacturers and Exporters, and the RBC Financial Group found that regulatory barriers and the cost of shipping and distribution were not significant impediments to exporting for a large proportion of SMEs canvassed in Canada and the United States. The study concluded that neither red tape nor transportation constitute a meaningful barrier to exports.[6]

Poisson et al. reported that insufficient human and financial resources, poor knowledge of Asian markets, and a lack of international experience among senior managers were the reasons behind Canadian SMEs' limited participation in Asian markets. They based this conclusion on surveys of Canadian firms conducted by Industry Canada and the Department of Foreign Affairs and International Trade.[7]

1 UPS, *UPS Business Monitor Canada.*

2 Crick and Spence, "A Comparative Study."

3 Orser et al., *Canadian SME Exporters,* p. 15.

4 UPS, *UPS Business Monitor Canada.*

5 CFIB, *Report on Trade.*

6 CFIB et al., *The Path to Prosperity*, p. 13.

7 Poisson et al., *Success Factors for Small and Medium-Sized Canadian Enterprises*, p. 3.

GETTING STARTED

The first impediments SMEs face when tackling the global marketplace are upfront issues related to obtaining market intelligence and information about strategic associations. While empirical data gathered from international surveys suggest that informational obstacles are not the chief reason firms decide not to internationalize,[8] these difficulties could explain why some SMEs are more comfortable concentrating on the domestic market. Information gathering and processing take time and can exceed the capabilities of many small enterprises.

Choosing the right entry strategy—for example, straight export sales rather than foreign investment or affiliation with a local partner—is another important consideration that strains the limited managerial and financial capabilities of SMEs. Vetting potential partners is a further consideration. Because of their small scale, SMEs do not have the same scope for experimentation that larger firms have and perceive their risks to be much greater.

ACCESS TO FINANCING

While access to financing is an issue for SME exporters, results of various surveys indicate that it does not rank as one of the largest concerns facing small firms in Canada.[9] Indications are, however, that it is a somewhat bigger challenge for Canadian SMEs than for those in the U.S., where the venture capital market is more developed.[10]

Financing is needed to conduct upfront R&D and market research and to finance accounts receivable. The Canadian banking sector is often criticized for offering too narrow a range of financial services to SME exporters. One problem SMEs have cited is that frequent account manager turnover at banks makes it more difficult to establish the long-term cooperative relationships that assist SMEs with their financing needs.[11] SMEs also maintain that it is difficult to obtain seed capital for riskier enterprises in sectors such as technology and health sciences. According to the International Monetary Fund (IMF), Canadian lenders appear to ration credit to riskier small ventures by simply choosing not to lend money, whereas in the U.S., high-risk loans are available but at a cost.[12] Statistics compiled by the Loan Pricing Corporation appear to confirm the IMF's observations about credit rationing in Canada. These figures show that the spread between rates charged for loans to high- and low-risk borrowers is considerably narrower in Canada than in the United States.[13]

THE CHALLENGES OF OPERATING IN GLOBAL VALUE CHAINS

One means of overcoming export barriers is for SMEs to participate in global supply chains. By aligning themselves with other players who are already active in foreign markets, smaller businesses can avoid some costs, such as those associated with doing market research or overcoming regulatory and trade impediments. Joining a global supply chain can also provide SMEs with an opportunity to leverage key assets of a larger partner, notably reputation.[14]

Coordinating operations with others so as to integrate into global supply chains can strain SMEs' resources.

However, participation in global supply chains brings a host of complex challenges to small enterprises. Chief among these is supply chain management. Coordinating and integrating operations with others in the chain—from suppliers and manufacturers to distributors and third-party services providers—can strain the resources of small enterprises. For example, retail supply chains

8 Westhead et al., "Issues Surrounding the Internationalization of SMEs."

9 Klyuev, *Show Me the Money*, p. 7.

10 CFIB et al., *The Path to Prosperity,* p. 25, and Maslach and McNaughton, "A Comparison of the Pace and Pattern of Internationalization," p. 164.

11 CFIB et al., *The Path to Prosperity*, p. 26.

12 Klyuev, *Show Me the Money*, p. 9.

13 CFIB et al., *The Path to Prosperity*, p. 20.

14 OECD, *Enhancing the Role of SMEs in Global Value Chains*, p. 4.

may require manufacturers to adopt their centralized electronic business systems.[15] SMEs are under pressure from their larger partners to merge to achieve a critical mass that can better support R&D, employee training, quality control, and standards.[16]

The root problem for most SMEs lies in the power asymmetry that can develop in global supply chains. As noted by the OECD, SMEs in a value chain control basic knowledge of individual processes and local clients. However, they tend not to understand how the chain structure operates and where the key assets reside. As a result, they are often in a weak negotiating position when dealing with the focal firms in the chain. The challenges are even greater for supply chain firms that concentrate their production on one product or service. Customization of production can be risky, since it can make the SME overly dependent on a single buyer.[17]

For SMEs to truly succeed in global markets, they need to allocate their limited resources to the activities that yield the greatest returns. Doing so is more complicated for SMEs operating within a value chain. The OECD's recent study of SMEs and global value chains sums up the challenge as follows:

> Indeed, value addition is key. It is mainly the pursuit of those productive activities with the highest return that make lead firms in the value chain decide on which activities to keep in-house and which to outsource. The distribution of tasks and the positioning of firms along the chain at stages corresponding to low or high value activities are largely determined by lead firms, but small firms rarely act as the lead firms of the chain.[18]

As the OECD notes in the same report, SMEs operating in global supply chains need to take on a larger and more complex set of tasks, such as product development, to enhance their returns and maximize their autonomy. For many SMEs, however, constraints on their managerial and financial resources make that an overwhelming challenge.[19]

SECURITY AND AUTHENTICATION

Doing business in other countries, particularly offshore locations, poses proportionately greater risks for SMEs than the risks undertaken by larger firms. Among the challenges facing SMEs that want to penetrate global markets are cultural differences, geographic distances, and uncertain political and legal environments. The fixed costs of obtaining legal and tax advice and of complying with security requirements are spread over a greater production base for larger corporations than for small ones.

SMEs in a global value chain are often in a weak negotiating position when dealing with the focal firms in the chain.

Authentication is a case in point. Exporters must often authenticate their identities when dealing with foreign partners, or verify the identities of their customers or suppliers. They usually do so using some combination of biometrics, smart cards, account numbers, passwords, or digital certificates. The upfront costs of implementing authentication systems can be overwhelming for SMEs.

Security is another significant issue for Canadian exporters, according to IE Canada. The average annual security budget for Canadian exporters with C$10 million in annual sales to the U.S. grew from C$64,000 in 2001 to C$270,000 in 2004. The budgets pay for physical security measures relating to such things as the transportation, handling, and storage of cargo; financial soundness; security of documents; and data and personnel security.[20] Security has no doubt become an even greater consideration since IE Canada conducted its survey in 2004.

15 Business Development Bank of Canada, "Supply Chain Management."

16 OECD, *Moving Up the Value Chain,* p. 21.

17 OECD, *Enhancing the Role of SMEs in Global Value Chains,* p. 21.

18 Ibid., p. 10.

19 Ibid., p. 66.

20 Campbell, "Security Savvy."

Security and authentication issues are compounded for SMEs that operate within global value chains. There are pressures to conform to procedures and systems dictated by others. Ironically, SMEs used to be the leaders in versatility and cost control. However, modern technologies and advances in authentication mean that larger corporations are automating their supply chains to achieve more production flexibility and lower unit costs. Smaller companies will have to adopt these new measures or they will be left behind.[21]

Security and authentication issues are compounded for SMEs that operate within global value chains.

PROTECTION OF INTELLECTUAL PROPERTY

According to a recent OECD study of SME experience in various countries, the management of intellectual assets is another critical consideration for SMEs operating within global value chains. Intellectual property protection is one consideration, particularly with respect to software. A second concern, however, relates to business plans. Focal firms in a supply chain will often demand complete transparency regarding all aspects of a supplier's business. SMEs are understandably concerned that this sensitive information might be passed on to alternative suppliers and used to undercut their bids.[22]

SUMMARY OF KEY CHALLENGES

While it is very difficult to get an accurate quantitative sense of the challenges SMEs face when addressing the international marketplace, a general picture emerges from a review of the business literature and survey results. Ranked by order of importance, the most critical impediments appear to be the following:

- identifying good market opportunities;
- finding reliable business partners;
- managing supply chain relationships and the demands of complying with quality control and systems requirements;
- getting access to financing;
- handling authentication and security;
- protecting intellectual assets and business information; and
- overcoming trade and regulatory barriers.

21 Economist Intelligence Unit, *The Global Supply Chain.*

22 OECD, *Enhancing the Role of SMEs in Global Value Chains*, p. 53.

CHAPTER 3

Observations on Globally Integrated SMEs

Chapter Summary

- Research indicates that new firms can be just as successful as established enterprises in accessing foreign markets, challenging the traditional view that firms begin exporting only after gaining a foothold in the domestic market.
- Indications are that the background and personal attributes of owner-managers are critical factors in determining whether a firm will internationalize and how successful it will be.
- SMEs that succeed in global markets tend to invest, export more than one product, and export to more than one destination.

New research into the attributes of globally integrated SMEs provides interesting insights into the ways industry, location, age of firm, type of export, and characteristics of owner-managers influence export outcomes in Canada. The picture that emerges is one that defies traditional perceptions.

Studies on the performance of Canadian SMEs in international markets indicate very strongly that size matters. One study noted the positive correlation between the size of Canadian SMEs doing business in emerging Asian markets and their performance.[1] Sabuhoro and Gervais' examination of Statistics Canada exporter registry data also found a relationship between firm size and export success for Canadian establishments.[2]

While on its face, this finding would seem to suggest that firms need only to grow to improve their export performance, research indicates that several more complex factors are at play.

Survey findings and recent empirical research challenge the traditional "stage" model, which assumes that firms graduate to export markets only after developing an established foothold at home.

The first revelation is that new firms can be just as successful as established enterprises in penetrating global markets. Survey findings and recent empirical research challenge the traditional "stage" model, which assumes that firms graduate to export markets only after developing an established foothold at home. A 2007 CFIB survey found that the percentage of SMEs reporting export activity was similar among firms in business for a year or less and those established for 10 years or more. Analysis of Statistics Canada's Business Register data shows that the average percentage of sales revenue accounted for by exports is the same for firms established

1 Poisson et al., *Success Factors for Small and Medium-Sized Canadian Enterprises*, p. 12.

2 Sabuhoro and Gervais, *Factors Determining the Success or Failure*, p. 14.

before 2001 as for newer firms.[3] These findings support the suggestion that firm age is a relatively poor predictor of export performance.

Indications are that many firms are "born global." Small, niche players that lack a sufficiently large domestic customer base to be viable in their home market alone often immediately enter the world market. Other "born globals" or international new ventures (INVs) pursue internationalization because they want to leverage a unique technological advantage and consolidate their market dominance by selling to multiple countries at their earliest stages. This tendency could explain why knowledge-based enterprises and firms in the manufacturing sector tend to be more export-oriented.

A recent analysis of Canadian SMEs noted that INVs are significantly smaller than established exporters, yet they achieve similar levels of export intensity within three years despite having a smaller workforce, younger and less experienced owners, and fewer capital assets.[4]

The second observation is that the international experience of the firm's senior managers is a critical element in determining a firm's success in foreign markets. Fischer and Reuber's findings show that owner-managers who have experience in international development or who have worked abroad earn a higher proportion of their sales from export markets, on average.[5] Recent analysis indicates that a disproportionately high number of established exporters are owned by immigrants who have resided in Canada for less than five years.[6] Other research suggests that entrepreneurs' capacity to handle risk and personal objectives are critical in determining whether a small company decides to internationalize, and which markets and associations it will pursue.[7]

3 Orser et al., *Canadian SME Exporters,* p. 15.

4 Ibid., p. 20.

5 Fischer and Reuber, "Targeting Export Support to SMEs."

6 Orser et al., *Canadian SME Exporters*, p. 16.

7 Westhead et al, "Issues Surrounding the Internationalization of SMEs"; Crick and Spence, "A Comparative Study"; and Maslach and McNaughton, "A Comparison of the Pace and Pattern of Internationalization."

A third ingredient is foreign investment activity. An analysis of Canadian SME activity in Asia suggests that Canadian SMEs that invest directly in emerging Asian markets exhibit higher rates of profit, sales, and market share growth than do firms that merely export to those markets. The authors attribute this difference to the fact that even though markets are notionally open, various protectionist measures slow exports or reduce their profitability.[8] The variation might also relate to increased trade in services, since the provision of many services requires a commercial presence in the importing country and might therefore require some kind of foreign investment by the services provider.

"Born global" companies are significantly smaller than established exporters, yet they achieve similar levels of export intensity despite fewer resources.

A fourth consideration relates to the product or service exported and the export destination. Research has also shown that the number of exported products, the number of export destinations, and the industry sector have a bearing on survival in foreign markets. Sabuhoro and Gervais reported that survival rates were higher for Canadian SMEs that exported more than one product, for those that exported to more than one destination, and for firms in goods-producing industries. Agricultural, fishing, trapping, logging and forestry, and manufacturing exporters faced the lowest risk of exiting export markets early. According to Sabuhoro and Gervais' analysis, risks were higher for firms in the mining, construction, communications, wholesale and retail trade, finance and insurance, and business services sectors. Their study underlines the uncertainty SMEs face when dealing in global markets. According to their results, the likelihood of a Canadian establishment exiting a foreign market within the first 12 months is 42 per cent.[9]

8 Poisson et al., *Success Factors for Small and Medium-Sized Canadian Enterprises*, p. 15.

9 Sabuhoro and Gervais, *Factors Determining the Success or Failure*, p. 8.

CHAPTER 4

Business Success Strategies

Chapter Summary

- The experience of successful SME exporters can provide useful lessons for enterprises interested in tapping international markets.
- SMEs are advised to adopt measures to enhance their technological and innovative capacity, particularly when they are considering participating in global value chains.
- SMEs also need to consider their market entry strategy carefully; it should not be limited to exporting and can range from purchasing foreign inputs to undertaking equity investments in foreign markets.

It is important to recognize that it is neither practical nor desirable for all SMEs to engage in the global marketplace. Some do not produce a good or service that is even possible to sell in foreign markets. For other firms with limited managerial or financial resources, the obstacles to foreign investment or exporting could be impossible to overcome. For many, the risks and costs are simply not worth the benefits.

For those able and willing to make the commitment to global markets, however, it is worthwhile to translate what we know about successful global SMEs into concrete business strategies. Based on what appear to be the key characteristics of successful global SMEs, the strategies can be broken down into the following categories:

- Implement measures to enhance firm competitiveness.
- Select the best entry strategies and make the most advantageous affiliations with export partners.
- Decide on the right export products or services, and export markets.
- Take advantage of government assistance and cooperative arrangements with other firms.
- Adopt specific measures to comply with security, authentication, and other trade requirements.

Before approaching global markets, SME managers should adopt best practices for managing and investing in innovation and aggressively adopt new technology.

KEY ELEMENTS OF SUCCESSFUL STRATEGIES

MAXIMIZE COMPETITIVE POSITION

Case studies suggest that before even approaching international markets, firms should invest in maximizing their competitive position. According to a study conducted by the CFIB, Canadian Manufacturers and Exporters, and the RBC Financial Group, SME managers should adopt best practices for managing and investing in innovation; aggressively adopt new technology; invest in productive capital; become more open to the benefits of shared control, so that they can seek the types of financing necessary to achieve growth objectives; and embrace R&D activity. The last point is a particular challenge for SMEs, since—according to a survey cited by the joint study—6 in 10 SMEs in Canada and the United States spend nothing at all on R&D.[1]

A recent OECD analysis of international SME experience also highlights the critical importance of measures to improve the technological and innovative capacity of firms positioning themselves to participate in global supply chains.[2] Innovation can provide SMEs with a comparative advantage over their competitors, if they can develop a product or service that defies imitation and can therefore command a high price. The critical importance of innovation to firm growth and performance is confirmed by Baldwin and Gellatly's research on Canadian businesses,[3] as well as Orser et al.'s analysis showing that exporter SMEs are significantly more likely than non-exporters to invest in R&D.[4]

SELECT THE RIGHT MARKET ENTRY STRATEGY

Determining the right market entry strategy is a critical decision for exporting companies, and the arrangement chosen can have an important bearing on the success of the global venture. The options are numerous and can be thought of as a continuum ranging from purchasing foreign inputs to undertaking equity investments in foreign markets. For information on some of the alternative arrangements, see box "Strategic Alliance Options for Interacting in Global Markets."

The product or service exported, the degree of after-sales service needed, and the amount of customization required often dictate the choice of entry strategy. The distance to the export market, the presence or absence of trade barriers, the degree of political and financial risk, and the nature of competition also affect that choice. Often, firms first enter foreign markets by responding to unsolicited export orders; others proactively target foreign business. Serendipity plays a role in many cases. While large firms tend to engage in advance strategic planning, smaller companies' decisions are more likely to arise from chance opportunities. Management attributes—such as the international experience, social networks, and even vacation choices of owner-managers—determine the internationalization pattern of many SMEs.[5]

Obviously, while no ideal entry strategy applies to all situations, there is some evidence that SMEs that undertake FDI exhibit higher returns in international markets.[6] FDI might also offer potential for technological learning.[7] However, offshore investment is beyond the capability of most smaller enterprises, since they typically lack both the financial resources and the managerial capability to undertake the necessary research and analysis.[8] Indeed, Kennedy and Wright's examination of investment data compiled by the United Nations Conference on Trade and Development (UNCTAD) found that Canadian SMEs approach FDI quite differently than larger companies do.

According to Kennedy and Wright, Canadian SMEs operating in Asia undertake FDI in stages. Most begin in international markets as exporters and make investments only after they have gained confidence and experience. Alternatively, SMEs that are part of multinational supply chains may undertake FDI while following a major client abroad. Smaller firms rarely engage in greenfield investment, mergers, or acquisitions; rather, they team up with local partners in joint ventures or similar kinds of associations. Indications are that Canadian SMEs are more likely to invest in plant machinery and equipment than in buildings or land.[9]

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1 CFIB et al., *The Path to Prosperity*, pp. 12–13.

2 OECD, *Enhancing the Role of SMEs in Global Value Chains*, p. 53.

3 Baldwin and Gellatly, *Innovation Capabilities*.

4 Orser et al., *Canadian SME Exporters*, p. 16.

5 Kennedy and Wright, "Overview of the Canadian Presence in Southeast Asia," p. 12.

6 Poisson et al., *Success Factors for Small and Medium-Sized Canadian Enterprises*, p. 15.

7 Westhead et al, "Issues Surrounding the Internationalization of SMEs," and Crick and Spence, "A Comparative Study."

8 It is possible that by forming alliances with other Canadian firms, SMEs could cooperate on export promotion, distribution, technical support, and other activities, thereby reducing some of the risks and costs of internationalization.

9 Kennedy and Wright, "Overview of the Canadian Presence in Southeast Asia," p. 12.

Strategic Alliance Options for Interacting in Global Markets

Export-Import
- Import of inputs
- Ad hoc exports—that is, exports made by fulfilling specific orders received from a foreign customer
- Exports done through independent agents or distributors
- Exports conducted remotely through the firm's domestic sales force, with no sales staff in the export market
- Exports made using on-site sales and after-sales staff abroad

Contractual Arrangements With Foreign Firms
- Licensing or franchising arrangement
- Technical agreement or service contract
- Manufacturing subcontract or co-production agreement
- R&D collaboration

Direct Investment
- Joint venture
- Partially owned subsidiary or joint venture (acquisition or greenfield)
- Wholly owned subsidiary (acquisition or greenfield)

Source: Compiled from different sources by the author for The Conference Board of Canada.

BROADEN PRODUCTS OR SERVICES OFFERED, AND EXPORT DESTINATIONS

A considerable amount of upfront research is needed to determine which products or services to export, to which markets and using what entry strategy. Sabuhoro and Gervais' analysis shows a positive relationship between the number of different products exported and the number of export destinations, and export survival rates.[10] While many exporters merely respond to market orders and cannot offer a range of products to a wide group of customers, it seems clear that efforts to broaden and differentiate export offerings could reduce the pitfalls of dependence of a single buyer. There is obviously a fine line between too much and too little product and market diversification, and that is particularly true for SMEs. It seems critical for SMEs to concentrate on the most promising market opportunities and to spread the risk to the greatest practical extent.

Regarding destination markets, SME exporters typically focus on only one or two export markets because of their limited resources. As studies have found, the experience and preferences of owner-managers often play a decisive role in the export destinations SMEs choose. That suggests that SMEs would be well advised to engage employees with international backgrounds to lead their efforts to penetrate global markets.

The more export destinations and products exported, the greater the chance that the export strategy will succeed.

For reasons of geographic proximity and similarity in language, regulations, and trade regimes, the United States is a more accessible export destination than offshore markets. However, Kennedy and Wright believe that Canadian investors are generally too focused on the U.S. market and are ignoring promising investment opportunities elsewhere, such as in Southeast Asia. They point to OECD estimates of trade multipliers showing that FDI in emerging economies can generate two dollars of export revenue for every dollar of FDI, compared with only 60 cents of export revenue for similar investments made in mature economies. They also cite other measures of FDI potential, such as UNCTAD's FDI potential index, which rank some Asian countries such as Singapore very highly as investment destinations.[11] It is possible that SMEs are missing an opportunity to leverage the advantages of Canada's ethnically diverse, multilingual workforce by concentrating too closely on the U.S. market.

Finally, it is worth considering the possibility that Canadian SMEs might be more competitive in delivering services rather than manufactured goods in emerging markets, as our relatively high labour costs put us at more of a disadvantage in relation to goods.

10 The export products need not be greatly diverse but could be closely related. Sabuhoro and Gervais' analysis was based on the number of eight-digit Harmonized System products exported. Sabuhoro and Gervais, "Factors Determining the Success or Failure."

11 Kennedy and Wright, "Overview of the Canadian Presence in Southeast Asia," p. 7.

LOOK TO OTHERS FOR ASSISTANCE

SMEs can also turn to each other for support and assistance. Industrial clusters can create a critical mass for such things as employee training and quality control. Canada has relatively few clusters, compared with the United States. Particularly in the technology and health sciences sectors, clusters can provide individual firms with access to an R&D network, and to commercial and marketing expertise. Clusters can also give investors confidence that smaller firms can access broader resources and know-how.[12]

There are many different types of clusters. Some merely share information, while others pool resources. Participants in some particularly ambitious clusters will undertake joint ventures.

It is also possible that government programs could improve a small firm's success in global markets. Yet one of the most striking results arising from surveys of SME exporters is that SMEs have little knowledge of government measures available to assist them. CFIB surveys have found that only a small minority of SMEs use government programs designed to encourage and assist exporters.[13] OECD observations confirm this trend at the international level.[14]

12 CFIB et al., *The Path to Prosperity*, p. 26.

13 CFIB, *Report on Trade*, p. 5.

14 OECD and Asia Pacific Economic Cooperation, *Global Conference on Removing Barriers*, p. 5.

ADDRESS SPECIFIC TRADE IMPEDIMENTS

There are concrete steps SME exporters can take to overcome some of the disadvantages of size. For example, IE Canada urges Canadian firms doing business with the United States to comply with the requirements of accredited security programs, such as those championed by the World Customs Organization, to overcome concerns about security and authentication. The World Customs Organization awards its Authorized Economic Operator designation to companies demonstrating a commitment to supply chain security; compliance with customs requirements; and participation in a customs-business partnership program, such as the Customs Trade Partnership against Terrorism.[15] While most of IE Canada's recommendations pertain to larger exporters doing business with the United States, issues of security and authentication are important for small businesses as well, particularly for firms involved in supply chains with American partners.

15 Campbell, "Security Savvy."

CHAPTER 5

Support Strategies

Chapter Summary

- Larger businesses can benefit through collaborations with SMEs, and can assist them by participating in industrial networks to pool resources and share information.
- Most SMEs do not take advantage of existing government programs to assist exporters.
- There might be some benefit to tailoring government assistance to the specific attributes of SME owner-managers, particularly those at "born global" firms; encouraging outward investment; and continuing to cooperate with other governments on tax coordination, reductions in trade barriers, and intellectual property and security matters.

More globally integrated SMEs benefit the broader economy. It follows that the challenges of achieving global integration should not rest entirely with SMEs themselves. Other members of the business community, particularly larger firms that operate within global value chains, may be interested in helping SMEs internationalize. Global value chains are dynamic entities that need to be internationally competitive to ensure the viability of their members.

THE ROLE OF LARGER BUSINESSES AND BUSINESS ASSOCIATIONS

Affiliations with SMEs provide larger businesses with an opportunity to outsource tasks to lower cost operators. The flexibility and ingenuity of smaller enterprises can improve the competitive position of larger firms. The Internet makes it easier than in the past to identify collaborative opportunities and make these connections. However, larger players need to do a better job of understanding the potential offered by SMEs and leveraging it. One way they can do so is by forming and participating in industrial clusters.

The flexibility and ingenuity of smaller enterprises can improve the competitive position of larger firms.

Business associations could foster networks and encourage participation by SMEs as well as by larger enterprises. These associations could also help coordinate the adoption of international standards relating to security, authentication, and protection of intellectual assets. As surveys have shown, these are concerns for many SMEs. Business groups could take the lead in convincing their members, both large and small, to work with agencies such as the World Customs Organization, the OECD, the World Intellectual Property Organization, and others to implement common standards and appropriate safeguards.

EXISTING POLICY MEASURES

Federal, provincial, and territorial governments in Canada operate many programs to assist companies interested in exporting. Many of the programs are designed to provide market information and advice. For example, the federal department of Foreign Affairs and International Trade Canada's Trade Commissioner Service operates in 140 missions worldwide through a network of more than 500 trade commissioners. While they provide core services to any Canadian organization with a demonstrated capacity for and commitment to internationalization, most of their clients are small businesses.

There are also a number of programs to assist SME exporters with financing. Export Development Canada provides export financing and insurance. Industry Canada administers loans available under the *Canada Small Business Financing Act*, whereby government shares in the risk of loans provided by private sector lenders. Eligible businesses with annual gross revenues of up to C$5 million can receive loans of up to C$250,000. Under the program, the government shares in the cost of losses by reimbursing 85 per cent of eligible losses on defaulted loans.

Industry Canada's *Exporting Info Guide* conveniently outlines the federal and territorial assistance available to potential exporters, from international trade training and export assistance to market intelligence and data. Appendix A of this report summarizes these programs. Provincial governments also provide a number of support measures. Information on assistance programs is available from business organizations such as the Canadian Chamber of Commerce and the CFIB.

While there are many government programs that encourage internationalization, indications are that few SMEs use them. There are several possible explanations for this fact. According to the OECD, many SMEs are simply unaware that the programs even exist, due to their limited understanding of the global environment.[1] Put another way, SMEs lack the knowledge to know what they do not know. An alternative explanation is that the programs are poorly designed and/or communicated. Related to this idea is the possibility that SMEs lack the resources to interact with government and to meet the requirements for assistance. For example, they may not have the time or skills to complete the necessary applications or prepare the required business plans. Still another explanation for SMEs' apparently weak take-up of available government programs is that the greatest challenges hindering SME access to global markets cannot be addressed by government policy but lie instead within the domain of private commerce. These challenges include adopting the correct entry strategy, choosing the right export products and markets, and making advantageous investments or corporate alliances.

NEW AREAS FOR POLICY ATTENTION

Governments have recently undertaken new initiatives to help SMEs in their international efforts. For instance, the federal government's 2007 Global Commerce Strategy aimed to improve foreign investment and other opportunities for Canadian businesses. Based on analysis of the experience of globally integrated SMEs, however, there may be some scope for improved policy measures in the following areas:

- advice geared to the specific attributes of owner-managers;
- programs to encourage outward investment;
- reductions in trade impediments, such as tariff and non-tariff barriers, and improvements in transportation infrastructure; and
- cooperation with foreign governments and international agencies to address tax coordination, security, and intellectual property issues.

BASE ASSISTANCE ON OWNER-MANAGER ATTRIBUTES

Many government support programs are geared to established businesses that have a meaningful domestic presence. These programs are predicated on the idea that firms require information and advice to make the jump from domestic to foreign markets. According to Fischer and Reuber, the Canadian government might have erroneously relied too heavily on the "stage" model

1 OECD, *Enhancing the Role of SMEs in Global Value Chains*, p. 61.

in the past. They feel that the stage model, which assumes that small companies begin by producing for the domestic market and evolve into exporters over time, lacks theoretical rigour. Fischer and Reuber maintain that instead of focusing on the characteristics of a firm, governments should tailor support programs to the characteristics and requirements of owner-managers. Their analysis suggests, for example, that firms headed by individuals with international connections and experience are more likely to be internationally oriented.[2]

There might be scope for encouraging new private SMEs to engage in global markets from the very outset. One means of doing so would be to focus on the characteristics of SMEs most likely to achieve international success and to address the specific obstacles most likely to hinder them.

ENCOURAGE OUTWARD INVESTMENT

Business research also suggests that SMEs that undertake foreign investments before or while exporting are generally more successful than firms that merely export. Foreign investment is also critical to the establishment of supply chains. This fact could have policy implications. There is little financing available for cross-border business ventures. The explicit mandate of most federal and provincial government programs is export promotion, not the promotion of outward investment. In February 2006, for the first time, EDC provided financing for direct investment in a project in China. Foreign investment financing assistance for SMEs might be worthy of further examination.

DISMANTLE BARRIERS TO TRADE AND INVESTMENT, AND IMPROVE TRADE INFRASTRUCTURE

There is also scope for governments to reduce some of the logistical impediments to trade that SMEs have identified as barriers to export. One important issue is the regulatory demands associated with moving goods across borders. While these requirements do not relate only to SMEs, the costs of trade impediments are proportionately higher for smaller enterprises.

2 Fischer and Reuber, "Targeting Export Support to SMEs."

The World Bank's Doing Business Project objectively ranks 178 economies based on their business regulation and enforcement. For the April 2006 to June 2007 period, Canada ranked seventh on the list, behind Singapore, New Zealand, the United States, Hong Kong China, Denmark, and the United Kingdom. Canada received a high score for the ease of starting a new business but ranked poorly in terms of enforcing contracts (43rd) and trading across borders (39th). The latter criterion relates to the costs and official procedures involved in exporting or importing a standard shipment of goods, from the date of the final contract between the parties to the delivery of the goods. It took 7 days to complete an export from Canada and cost US$1,385, compared with 6 days and only US$960 from the United States. For imports, the figures were 11 days for Canada compared with only 5 days for the United States, and US$1,425 in Canadian import costs versus US$1,160 for the United States.[3]

While trade and investment barriers have fallen sharply over the past 20 years, restrictions still exist. Stronger investment protection agreements with emerging economies would give assurance to SMEs considering operating in those markets. Negotiations aimed at reducing remaining tariff and non-tariff barriers would help open new foreign markets to Canadian SMEs. Equally important in the new trade paradigm are reductions in Canadian trade barriers to lower the cost to SMEs of imported inputs and semi-finished components.

A related trade policy issue concerns rules of origin. According to data reported by Export Development Canada, the average Canadian content of manufacturing exports has fallen sharply since 1990.[4] Strict rules of origin stipulations under the North American Free Trade Agreement (NAFTA) prevent firms from outsourcing certain manufacturing tasks to non-NAFTA countries without giving up the benefits of NAFTA's tariff-free treatment. The three NAFTA governments have been working together to simplify and ease some

3 The World Bank Group, "The Doing Business Project."

4 Statistics Canada, *Tracking Value-Added Trade.*

of the rules of origin requirements. However, more could be done in this area to better integrate Canadian companies into global supply chains.[5]

Another important area is the movement of personnel. SMEs that export services are often more likely than larger enterprises to rely on temporary movement of their employees to deliver services to foreign customers. This fact underlines the importance of ongoing efforts to negotiate with our trading partners for better access in this area.

Infrastructure has an important bearing on the movement of goods across borders. Business surveys have indicated that inadequate airport and port facilities limit our ability to meet export targets. Road, bridge, and rail infrastructure is equally important. A recent study by The Conference Board of Canada examined bottlenecks at the Port of Vancouver and other exit and entry points.[6] Public investments in this area would benefit small and large exporters alike.

Air links are another transportation issue. Many services providers—particularly SMEs, whose limited resources can make it impossible to establish a permanent foreign commercial presence—need face-to-face contact with their customers. Participants at the 2006 Asia Pacific Summit argued for the negotiation of more flexible air arrangements with their Asian counterparts to facilitate the movement of people and shipments.[7]

COORDINATE WITH OTHER GOVERNMENTS

Another role for Canadian governments falls under the general category of coordination. Some SMEs cite the difficulties of negotiating different tax regimes and complying with different product certification standards as barriers to export and investment. Larger companies have the resources to understand and adhere to the requirements of various jurisdictions. Governments could assist SMEs by working with other countries to streamline and harmonize regulatory and certification standards. An example of this kind of cooperation in which Canada is an active participant is the work being conducted at the OECD on transfer pricing guidelines. An expert group on SMEs and value chains, spearheaded by the United Nations Expert Group, provides some good recommendations regarding convergence of certification procedures and product standards. Among other things, it suggested that governments work in regional groups to streamline regulations, improve trading infrastructure, and develop one-stop window systems for SMEs.[8]

Some SMEs participating in supply chains have expressed concern that their intellectual property rights might not be properly safeguarded. Governments might consider revising the OECD Guidelines on Multinational Enterprises (MNEs) to include provisions for technology transfers from small contractors to MNEs. The guidelines already provide voluntary principles and standards for responsible business conduct in various areas, such as employment, bribery, competition, and taxation. All 30 OECD countries and 10 others adhere to them.[9]

International standards could also help SMEs address authentication and security issues. International firms surveyed by the Economist Intelligence Unit urged the United Nations to designate authentication standards to help companies better integrate into global supply chains.[10]

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5 Poloz, "NAFTA Rules of Origin."

6 Brooks, *Addressing Gaps in the Transportation Network*.

7 Asia Pacific Foundation of Canada, *Asia Pacific Summit 2006.*.

8 United Nations Economic and Social Commission for Asia and the Pacific, *Expert Group Meeting*.

9 OECD, The OECD Guidelines for Multinational Enterprises.

10 Economist Intelligence Unit, *The Global Supply Chain*.

CHAPTER 6

Conclusion

Chapter Summary

- Few Canadian SMEs are globally engaged on a regular basis.
- SMEs should carefully consider their business strategy before going global.
- Larger companies can benefit by helping SMEs globalize.
- There may be scope to improve government programs designed to help SMEs enter international markets.

Indications are that only a few Canadian SMEs are globally engaged on a regular basis. While globalization is not a realistic option for many, some SMEs want to be active in global markets but are overwhelmed by obstacles that might be overcome through a combination of business strategy, support from larger enterprises, and government assistance. Business research suggests that new firms can be just as successful as established enterprises in foreign markets, challenging the traditional view that small firms must start off domestically and graduate to international markets with time and experience. Research also suggests that the background, attitudes, and personal attributes of owner-managers are critical factors in determining whether and how an SME will engage in international markets.

Based on the experience of successful international SMEs, smaller enterprises should focus on enhancing their technological and innovative capacity, and on carefully considering the most advantageous export entry strategy and product or service mix. Large companies can benefit from interactions with SMEs, particularly through global value chains, and can help SMEs by sharing ideas and resources with them in industrial networks.

Smaller enterprises should focus on enhancing their technological and innovative capacity.

Few SMEs take advantage of government export assistance programs. There may be scope to improve existing programs by tailoring them to the personal attributes of owner-managers and by using them to foster outward investment. Given the disproportionate burden that trade barrier, security, tax, transportation, and intellectual property considerations impose on small exporters, government efforts to reduce these impediments by coordinating with our trading partners are also very important.

Better data and analysis would greatly enhance our understanding of how SMEs internationalize and how they might overcome the obstacles they face. Existing analysis underlines the need to reconsider the ways SMEs interact with the global marketplace. More research on the international experience of SMEs is certain to help us better assist them in achieving their objectives.

APPENDIX A

Federal Government Assistance Programs for Small Business Exporters

Table 1
General Assistance

Government Agency or Department	Available Services
Foreign Affairs and International Trade Canada	• Virtual trade commissioner • Commercial delegations • Missions abroad • Financial assistance • Market research • Networking and business services through Canadian embassies abroad
Export Development Canada	• Export financing • Insurance • Bonding
Canada Border Services Agency	• Training
Canadian International Development Agency	• Funding for international development programs and projects with contracts for Canadian companies
Business Development Bank of Canada	• Export financing; equipment and realty financing; and financing of working capital and intangibles • Customized consulting services and training programs for entrepreneurs
Canadian Commercial Corporation	• International contract advisory services • Government guarantees to help small exporters with insufficient working capital undertake specific export contracts
Industry Canada Strategis	• Consulting services for exporting • Information on international markets • Advice on export programs and services • Recruiting for trade shows and commercial missions
Forum for International Trade Training	• National certification standards for, and education in, international trade

Source: Compiled from different sources by the author for The Conference Board of Canada.

Table 2
Assistance for Specific Sectors

Government Agency or Department	Available Services
Agriculture and Agri-Food Canada	◆ Certification ◆ Market studies ◆ Statistics
Farm Credit Canada	◆ Small business services for agri-business ◆ Financing ◆ Contract services ◆ Insurance
Telefilm Canada	◆ Assistance for the film industry
Heritage Canada	◆ Assistance for the cultural, publishing, music, and arts industries
Association for the Export of Canadian Books	◆ Market promotion ◆ Financial and logistical support for book exporters
Canadian Technology Network	◆ Consulting and commercial services ◆ Networking
Canada Mortgage and Housing Corporation	◆ Export promotion services and international relations for housing developers

Source: Compiled from different sources by the author for The Conference Board of Canada.

APPENDIX B

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APPENDIX C

Related Products and Services

The International Trade and Investment Centre (ITIC)

The Centre's main aim is to help Canadian leaders better understand what global economic dynamics—such as global and regional supply chains—mean for public policies and business strategies. The Centre promotes informed dialogue on Canada's global economic role through independent, clearly communicated, evidence-based research. It contributes to enhanced Canadian living standards by providing a sound basis for business and government decisions that enhance trade and investment outcomes. For more on the Centre's research and events, see www.conferenceboard.ca/ITIC.

Recent Centre publications include:

Stuck in Neutral: Canada's Engagement in Regional and Global Supply Chains

This report takes an original look at how Canadian companies fit into other regions' supply chains and how those regions fit into Canadian supply chains. Unlike conventional trade analysis that tends to assume two countries trade in final goods, this report examines Canada's trade with other regions through the eyes of the buying region's supply chain.

Canada's "Missing" Trade With Asia

Conventional statistics undercount the quantity of international trade, especially in services and by foreign affiliates. This report assesses the magnitude of Canada's "missing trade" with Asia and looks at current and future trends.

Trends in Foreign Direct Investment and Mergers and Acquisitions: International and Canadian Performance and Implications

Recent foreign purchases of large Canadian companies have raised concerns that Canada is being "hollowed out." This report predicts that merger and acquisition activity will slow over the near term due to the high Canadian dollar and weaker profit growth in the United States.

Other reports of interest include:

The Benefits of Foreign Direct Investment: How Investment in Both Directions Drives Our Economy

This report examines the benefits of foreign direct investment (FDI)—both Canadian investment abroad (outward FDI) and foreign investment in Canada (inward FDI).

Is Corporate Canada Being Hollowed Out? It All Depends Where You Are

This briefing is an excerpt from Volume I (*Mission Possible: Stellar Canadian Performance in the Global Economy*) of the final report of The Canada Project, *Mission Possible: Sustainable Prosperity for Canada*. It discusses the importance of the nature of foreign direct investment, the corporate form of multinational enterprises operating in Canada, and the head office and other business functions of multinationals in this country.

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