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Going Global: Factors Influencing U.S.-based SMEs' International Market Access

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ABSTRACT

Globalization promotes vast business opportunities for trade, flow of capital, ideas, and people. In order to integrate into the global economy, countries tend to promote policies, which in turn, help to remove barriers to the flow of investment, goods, and services. While there is ample information describing how multinational corporations have benefited from globalization through greater access to international markets and investment, there is a need to identify ways to unburden small to medium-sized enterprises so that they can reach their potential in the global economy. Barriers vary across business sectors. However, there are fundamental impediments that prevail, in general. The barriers to SME exports add to the resistance of their leaders to launch businesses outside of the NAFTA region. This descriptive paper summarizes international trade activity of US-based SMEs and focuses on key export barriers to US-based SMEs. An analysis of demographics and purchasing power of and Brazil, Russia, India and China is conducted, suggesting opportunities for US-based SMEs export to those markets.

INTRODUCTION

Globalization has opened world markets to United States' businesses, including small to medium-sized enterprises (SME) at an unprecedented rate. Due to advances in transportation and communication, globalization continues to change and challenge the nature of conducting business. It brings vast expansion of market opportunity that goes well beyond multinational corporate businesses. The expansion of an emerging middle class in Brazil, Russia, India and China (BRIC), for example, offers SMEs untold export opportunities. However, there are real and imagined barriers to transforming United States' (US) small to medium-sized enterprises (SMEs) into international enterprises exporting to more than one country, which is the typical profile of American SMEs.

This article summarizes the international trade activity between US-based SMEs with BRIC countries, and key impacts of globalization on prospects of these businesses to expand their international reach to the developing BRIC economies. The descriptive study focuses on the following questions: 1) "What are the barriers and opportunities to US-based SMEs to position themselves to be competitive internationally. 2) Why should US SMEs consider exporting to BRIC economies?" Further, the article provides an overview of globalization and internationalization theories which focus on multinational corporations (MNCs) than on SMEs. This is followed by a discussion about the BRIC economies, US trade policy and impact on SMEs. This paper provides an overview of US exports, an examination of the contribution of SMEs to US trade around the world, and describes barriers faced by SMEs.

GLOBALIZATION AND RESEARCH ON INTERNATIONALIZATION OF FIRMS

Globalization involves the integration of economies through increased trade, flow of capital, ideas, and people. In order to integrate into the global economy, countries promote liberalization policies, which in turn help to remove barriers to the flow of investment, goods, and services. There are a number of factors associated with the process of globalization. The integration of financial markets and the resulting flow of capital in the form of investments form a world economy. According to International Monetary Fund (2008) the value of trade of goods and services as a percentage of GDP has increased by 20 percentage points, from 42.1 percent in 1980 to 62.1 percent in 2007. Over 1980 to 2006, foreign direct investments have increased from 6.5 percent to 31.8 percent (International Monetary Fund, 2008). Advancements in transport and communication technology have extended the reach of finance and brought countries closer, thus increasing the scope and scale of conducting business. In spite of the reduction in transportation cost, large companies conduct the vast majority of international business with limited involvement on the part of SMEs.

Some of the theories frequently used to explain the internationalization efforts of large business include product life cycle model (Vernon, 1966), stage theory (Johanson and Vahlne, 1977), monopolistic advantage theory (Hymer, 1976), and eclectic theory (Dunning and Narula, 1998). These theories focused on the role of innovation and internationalization efforts of the firm, process of internationalization, and the locational, ownership and organizational advantages that firms and host economies offer. Based on the size of the organization, MNCs have greater access to capital, technological know-how and have the resources to operate at a global scale. These organizations have greater access to export market by virtue of economies of scale, which they enjoy, and their ability to enter into the foreign market. On the other hand, host countries possess advantages, which relate to market: internal and external, skilled and un-skilled labor, infrastructure, and government policies to promote a productive business environment. According to Khanna, Palepu and Sinha (2005) initially many MNCs failed to understand the importance of local customer preferences, challenges associated with infrastructure, and policy differences in developing countries. As a result they preferred to invest and conduct business in the developed countries. Therefore, international trade theories must go beyond MNCs to include SME trade and investment opportunities.

OVERVIEW: BRIC ECONOMIES, US TRADE POLICY AND ROLE OF US-BASED SMES

In 2006, there were 26.8 million US-based SMEs (United States Small Business Administration, 2007), which is less than 1% (239,287) exported goods, accounting for 28.9% of export value but 97% of export activity (United States Department of Commerce, 2006). Large companies, those employing more than 500 workers, represented over 71% of known export value, but only 3% of US exporters (United States Census Bureau, 2008).

United States' SMEs are grossly under-represented in the global markets, with a few exceptions including Canada and Mexico as seen in Table 1. According to the United States Census Bureau (2008), 58% of all US-based SMEs exported to only one international market in 2006, namely Canada or Mexico. As shown in Table 1, nearly four times more US-based SMEs trade with Canada than trade with China. Since Canada and Mexico are our key North American Free Trade Agreement (NAFTA) partners, these statistics are not surprising. However, given the population projections of emerging world markets, and the many changes that globalization has brought, it is surprising the US business is so narrowly focused.

US companies could benefit from expanding their export activities to developing and emerging countries. BRIC's long-term sustainable growth should be of interest to SMEs worldwide. According to O'Neil (2001) the BRIC economies would account for over 10% of the world's GDP by 2010. O'Neil's prediction has proven to be conservative since as of June 2008, the BRIC countries' combined economic power makes up 15% of the global economy (Symmons, 2008). Since 42% of the world's population (Population Reference Bureau, 2007) are represented by BRIC countries. Given the growth of both the population and emerging economies of BRIC, opportunities abound for US-based SMEs prepared to expand their export activities.

Table 1: US-based SMEs Export Destination Profile, 2006

Countries	Total US Exporters (#)	US-Based SMEs (#)	SME Exporters (%)	US SME Export Value (% of Total US Export Value)
Top five export destinations				

Canada	87,554	82,715	94.5	20.8
Mexico	44,204	40,929	92.6	27.5
United Kingdom	39,684	36,547	92.1	31.5
Germany	29,416	26,802	91.1	25.8
Japan	26,648	24,138	90.6	30.4
BRIC countries				
China	25,873	23,389	90.4	34.9
India	13,774	12,013	87.2	40.1
Brazil	13,465	11,627	86.3	28.5
Russia	4,684	3,885	82.9	50.5

Source: International Trade Administration, 2007.

US Trade Policy, SMEs and BRIC:

An important component of US trade policy is the free trade agreement (FTA). According to the US Trade Promotion Coordinating Committee (2007), 16% of US overall trade deficit resulted from FTA trading partners, while 84% of the trade deficit came from those countries with which the US lacked FTA agreements. Overall, FTAs appear to have been beneficial to US-based SMEs export business. According to the International Trade Administration (2007), US-based SMEs exported $82.1 billion of goods to American FTA partners, 36% of the total value of SMEs global exports in 2005.

According to the International Trade Administration (2008), in 2003 almost 95% of all companies that exported to NAFTA partners were SMEs. Moreover, SMEs accounted for the majority of exporting companies to other FTA partners as well. Since the primary purpose of the FTA is to level the international trade playing field, and SMEs appear to be cautious, if not reluctant, to engage in international trade too far from the secure NAFTA borders, it would seem reasonable to assume that SMEs will be wary of venturing into BRIC economies until the U.S. has at least negotiated FTAs with BRIC nations.

Of great interest to US-based SMEs should be the International Trade Administration's (ITA) short-term priorities for 2007-2008 focused on advancing U.S. international and commercial strategic interests by developing and implementing FTAs and other regional initiatives. Among the first priorities of this plan is to focus specifically on BRIC nations. The priorities include the expansion of business initiatives with China and India through bilateral efforts, completion of the Russian market access package, and launching a US-Brazil commercial dialogue (International Trade Administration, 2007b). Each of these initiatives is designed as steps towards the longer-term goal of FTAs with the BRIC nations.

PURCHASING POWER AND BRIC

According to Population Reference Bureau (2007) the BRIC countries account for over 43% of the world's population and these demographic trends will lead to a rise in the supply of labor force and create demand for goods and services. As the per capita income rises the emerging countries contribute towards additional growth of the global economy. This will help to grow the size of the middle class in these countries. In the year 2000, about 400 million people were classified as middle class and projected to increase to 1.2 billion by 2030 (World Bank, 2007). The US National Export Strategy included Brazil, China and India as its priority focus for US exports due to their growing economies. US exports to these countries combined in 2006 grew by 30% (Trade Promotion Coordinating Committee, 2007).

According to Deseglise (2007) the purchasing power of the middle class in China and India will continue to grow. In the case of China, the middle class is growing at a faster pace than the upper and lower income segments (Gadiesh, Leaung & Vestring, 2007). Further Farell, Gersch & Stephenson (2006) note that the middle class in China will be younger than those in the developed countries, ranging between 25 to 44 years, compared to 45 – 54 years in the advanced countries. This suggests a strong likelihood that demand will grow for new products. India has also witnessed a surge in the number of middle class citizens. By 2025, the middle class will account for 41% of the population, or 583 million. The middle class will primarily be concentrated in the cities and by 2025 nearly 75% of the urban population is projected to be categorized as middle class (Beinhocker, Farrell and Zainulbhai, 2007). Further, it is suggested that this segment of the population will spend nearly 70% of their income on discretionary products: Health care, recreation, education, personal products, transportation and other items.

Unlike China and India, Brazil faces economic stagnation. According to Elstrodt, Laboissiere and Pietracci (2007), Brazil is characterized by low cost of labor and low labor productivity. The country depends on a large informal sector workforce. As a consequence of the availability of cheap labor, presence of complex regulations, and high interest rates many businesses prefer to function in the informal sector (Musacchio, 2008). All of these factors impact the size of the middle class and the purchasing power of the population. Further as one looks at Russia, it is clear that the pace and scope of economic growth is expected to continue in the coming years. Over the last ten years the country's economy has grown by 7%. During the period 2002 to 2006, consumer spending increased by 107% and disposable income grew by 11% (Financial Times, 2008).

BARRIERS TO INTERNATIONALIZATION OF US-BASED SMES

Barriers vary across business sectors. However, there are fundamental impediments that prevail, in general. The frequently cited barriers to SME expansion into emerging markets include 1) inadequate national policies and bureaucracies, both US and export countries, 2) trade agreements and treaties to promote international trade, 3) long term capital financing and investment, 4) lack of intellectual property rights protection, 5) lack of international trade knowledge and experience, 6) bribery and corruption, 7) inadequate technology and e-commerce knowledge, 8) lack of or ineffective local partnerships and 9) misconception that international markets are suited for existing products and services, rather than re-engineering, distributing and packaging to fit the various cultural settings of the emerging markets (Trade Promotion Coordinating Committee, 2007; Fliess, and Busquets, 2006; Organisation for Economic Co-operation and Development, 2006).

Inadequate national policies and bureaucracies, both US and export countries

The most recent US government study, "Unlocking America's Potential" (Trade Promotion Coordinating Committee, 2002) surveyed 3,000 SMEs and conducted focus groups with 100 exporters. The study proposed several recommendations related to better customer service by US agencies to SMEs, access to financing, access to information about overseas market opportunities, need for early project development and lack of information about government programs to assist US businesses. However, the two major areas for improvement cited were 1) the need for US government services to be seamless and timely and 2) need coordinated assistance to SMEs in international markets.

According to the Trade Promotion Coordinating Committee (2007), doing business in BRIC countries is challenging due to bureaucracies at the central, provincial and local levels. Each country has its own challenges. For example, in China, enforcement of the law is inconsistent, lacking predictability, and an incomplete understanding of competition and free enterprise. Customs procedures and domestic regulations can be as much of an impediment to exporting as import tariffs (Fliess and Busquets, 2006). Facilitating US-based SME access to international markets is directly linked to the need for governments to standardize regulatory systems for an internationalized infrastructure in regulations and dispute resolution processes (Organisation for Economic Co-operation and Development, 2004).

Lack of trade agreements and treaties to promote international trade

The United States Department of Commerce (2008) states FTAs are especially important for SMEs since they reduce the cost of conducting business overseas and allow SMEs to become global players at a much faster rate. FTAs benefit SMEs in many ways including the lowering or eliminating tariffs, updating and enforcing laws on intellectual property protection, facilitating customs and providing a level playing field by addressing market access issues for specific industries. In BRIC countries, US exporters are impacted by the significant import tariffs and taxes. In Brazil, for example, the combination of high taxes and import tariffs can lead to doubling the price of goods (Trade Promotion

Coordinating Committee, 2007). The US does not have FTAs with any of the BRIC countries.

Need for long term capital financing and investment

According to Tobin (2006) the lack of financial resources can inhibit the expansion of SMEs. The Organisation for Economic Co-operation and Development (OECD), in cooperation with Asia Pacific Economic Cooperation (APEC), studied barriers to SMEs access to international markets. A key finding was that a majority of the SMEs reported the most problematic barrier was their own companies' internal capabilities. Interestingly, when the SMEs were broken down between experienced and non-experienced exporters, there was a significant difference. The companies lacking export experience cited the need for financial assistance and trade access. Those active exporters cited more concern with their own internal business operations (Organisation for Economic Co-operation and Development, 2006). Also, SME foreign direct investment can be an important strategy for larger SMEs to go global (Organisation for Economic Co-operation and Development, 2004).

Lack of intellectual property rights protection

Innovation is pervasive in the SME sector. Fixed costs and expenses of acquiring and enforcing intellectual property rights required for bringing inventions to market are a reality for all business. However, Jensen and Webster, (2006) determined that SMEs tend to have a higher rate of inventions than larger firms and more often seek and have more incentives to obtain intellectual property protections. Concerns of intellectual property right infringements are most often reported by SMEs related to emerging economies, most frequently cited are China and Russia (Fliess and Busquets (2006). However, India is also of significant concern (Trade Promotion and Coordinating Committee (2007).

Lack of international trade knowledge and experience

According to Prater and Ghosh (2005), US-based SMEs have traditionally invested in European countries and in Mexico and Canada. The former had priority due to familiarity with the business culture and long-term economic relations. US businesses have invested in Canada and Mexico perhaps due to geographic proximity, as well as trade agreements, such as NAFTA. Also, the time and resources required of SMEs to contend with deal with tariffs and trade barriers put a drain on the financial and human resources of these companies. They lack expertise of international trade and are resistant to invest in hiring legal advocates to help untangle the trade regulations (Fliess and Busquets (2006). There is a need for "how-to" guides to asses the novice SMEs interested in launching their export business (Organisation for Economic Co-operation and Development 2006).

Corruption and bribery

Lack of transparency is a fundamental impediment to conducting business. Bribery and corruption is pervasive and impacts local, national and global business. Transparency International (2008) indicates that bribery and corruption is a pressure on all businesses, but that SMEs are particularly vulnerable since they typically lack the resources to institute systems to resist bribery demands when conducting business around the world. Transparency International publishes an annual ranking of the perception of corruption in public sector organizations in the 180 world countries as reported by businesses and individuals. The rankings range on a 1 to 10 Corruption Perception Index (CPI) with 1 being the most corrupt rating. The 2008 rankings (Table 2) illustrate that BRIC countries are perceived as among the most corrupt in the world with Russia at 2.1, India and Brazil and China were ranked similarly at 3.4, 3.5 and 3.6 CPI respectively.

Table 2. Corruption Perception Index (CPI), 2008

Rank	Country	CPI
180	Somalia	1.0
147	**Russia**, Syria, Bangladesh, Kenya	2.1
85	**India**, Senegal, Panama, Serbia, Montenegro, Madagascar, Albania	3.4
80	**Brazil**, Swaziland, Burkina Faso, Saudi Arabia, Thailand, Morocco	3.5
72	**China**, Bulgaria, Macedonia, Peru, Mexico, Suriname, Trinidad, Tobago	3.6
18	USA, Japan, Belgium	7.3
1	Denmark, Sweden, New Zealand	9.3

Source: Transparency International, 2008.

Three of the BRIC countries, China, Brazil and India have comparable CPI ratings, with Russia perceived dramatically more corrupt. The least corrupt countries ranked as number 1 were Denmark, Sweden and New Zealand with a 9.3 CPI. The US is ranked 18 with Japan and Belgium. According to the Financial Times (2008), Russia's federal government's corrupt ties to big business supports large companies, leaving Russian SME businesses struggling to compete. The Trade Promotion and Coordinating Committee (2007) reports similar concerns with Brazil, India and China. BRIC Based upon the perceptions of corruption, US-based SMEs are cautious and reluctant to venture into the BRIC

Inadequate technology and e-commerce knowledge

Despite the considerable advancements made in transport and communication technology, SMEs perceive international trade to be too expensive. However, E-commerce represents a cost effective method by which means by which SMEs can enter the international marketplace. Experienced exporters can also utilize e-commerce tools to expand their reach. However, lack of knowledge and infrastructure a common concern by SMEs (Hornby, Goulding and Poon, 2002; Trade Promotion and Coordinating Committee, 2007).

Lack of or ineffective local partnerships

Further, the reluctance of SMEs may be explained by lack of knowledge about international partners and the resulting perception of high-risk. SMEs' excessive costs of travel and time invested trying to foster trading partner relationships impede their decision to consider exporting their products, or can also bring failure to international export efforts (Taylor, 2004). Also, understanding the customs and needs of the emerging marketplaces is crucial to SMEs success in export markets (Khanna, Palepu and Sinha, 2005; Prahalad and Hart, 2002). Furthermore, there are misconceptions that international markets are suited for existing products and services. Rather than attempting to re-engineer, distribute and package the product to fit the various emerging markets' cultural settings, often SMEs fail to address these localization factors. This impedes the internationalization efforts of SMEs (Prahalad and Hart, 2002). Local partners facilitate the understanding of emerging markets' needs and strategies to conduct successful business ventures.

Misconceptions that international markets are suited for existing products and services

Khanna, Palepu and Sinha (2005) provide a framework that can assist potential exporters to shape their strategies according to the realities found in each of the BRIC nations in applying the schema suggested, exporters, while not utilizing the identical strategies in all BRIC countries, can at least generate synergies by analyzing the distinct markets as part of a system. Prahalad and Hart (2002) advised that MNCs expand their focus beyond upper and middle class markets to the vast growing markets in emerging markets. Given that these markets have limited cash and inventory space, exporters must incorporate local markets lifestyles and not just seek to sell their American products to the emerging markets. They sight compelling examples of how changing from bulk to individual portion packaging will appeal to middle and low income customers. Research and development conducted in the local emerging markets is needed to develop products specific to those markets. The lessons to these MNCs have a direct applicability to the SMEs that can respond competitively.

CONCLUSION AND FUTURE RESEARCH

The world economy offers opportunities to both large and small businesses to go global. In the era of globalization, SMEs from the United States have further opportunities to expand in the manufacturing and service sectors. It is imperative that US-based SMEs adopt a global approach. Advancements in communication technology will further help to extend the scale and scope of SMEs. While there are many barriers to US-based SMEs to expanding beyond the NAFTA countries, the opportunities for American business to enter the newly emerging world markets are significant. The 2007 National Trade Strategy (Trade Promotion Coordinating Committee, 2007) has selected China, India and Brazil as the top three priority opportunities for US export trade development. Given that 42% of the world's population is in BRIC countries, and their economies are among the fastest growing in the world, US federal and state governments are committed to expanding US trade to these markets.

The most frequently cited barriers faced by US-based SMEs seeking to expand into emerging world markets include: Inadequate country specific policies and bureaucracies, lack of trade agreements and treaties, inadequate long term financing and investment, insufficient intellectual property rights protection, limited international trade knowledge and experience, bribery and corruption, lack of technology and e-commerce knowledge, need for effective local partnerships and lack of understanding of the heterogeneous needs of emerging markets and conducting business across various cultural settings. US-based SMEs need to have a global approach, going beyond NAFTA. International trade needs go beyond regional trade. US-based SMES should seek to expand and diversify their export markets to include the BRIC nations.

SMEs perceive so many barriers to launching their exports to emerging markets. Free trade agreements reduce these barriers while lowering the trade imbalances. Therefore, it is important for the US Government to aggressively seek free trade agreements with BRIC nations to assist US-based SMEs to overcome the many barriers that impede them from entering the global marketplace. These agreements may serve as incentives for SMEs to venture out to more diverse international markets.

This descriptive study leads to further research questions. What are the barriers that SMEs face in each of these BRIC countries? What specific industry sectors have the most potential for US trade expansion to BRIC? Why does the US trade strategy exclude Russia as a primary trading partner its 2007 export strategy? What business, export and in-country, opportunities exist for California SMEs to BRIC? Because of California's significant economy and its geographical location, the state's SMEs have export potential to Pacific countries. Are the needs identified by US-based SMEs comparable to California SMEs? What are the specific industry sectors' barriers to export expansion? Future research is needed to understand the landscape of California's SME business sectors and perceived barriers and opportunities for business expansion to BRIC countries.

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