

# Talking Points

## Small and Medium Enterprises in the Global Economy

By David Bartlett, Economic Advisor, RSM International

### Introduction

Small and medium enterprises, which played a crucial role in job creation and economic growth in the early and mid-2000s, incurred major setbacks during the Great Recession. In the European Union, SME employment fell by over three million jobs in 2009-10. American SMEs, which account for over 99 percent of non-farm employment in the United States, also reeled under the impact of the global downturn. For many SMEs still standing after the crisis, the continuing credit squeeze hinders access to the debt financing needed to expand their operations.

But the upheaval in the global economy has also generated important commercial opportunities for small and medium enterprises. The wave of bankruptcies ensuing from the Great Recession creates market openings for SMEs, whose competitive assets (speed, agility, responsiveness) better enable them to exploit niche market opportunities than large companies. The growing technological capabilities of SMEs allow them to leverage advances in biotechnology, renewable energy, and other high-growth global industries. Globally active SMEs are also well positioned to capitalize on the resumption of strong GDP growth in China, India, and other emerging markets.

This article examines the global activities of small and medium enterprises in Europe and North America, whose SME sectors occupy a key role in the economic recovery paths of the two regions.

### European SMEs

The development of European SMEs is a pillar of the Lisbon Strategy, launched by the European Council in March 2000 with the goal of making the European Union the world's most competitive economy by 2010.

Evaluations by the European Commission indicate that the Lisbon initiative fell short of key targets (R&D spending, labour force participation, et al). However, the SME-related provisions of the Lisbon Strategy did spur growth of small and medium enterprises in the European Union. Between 2002 and 2008, the number of active SMEs expanded by 13 percent (2.4 million new companies) against a five percent increase in large enterprises (200 new companies). SMEs outperformed big companies in job creation during this period, registering annual employment gains of 1.9 percent versus 0.8 percent in the large enterprise sector.

Large European companies retain an advantage in labour productivity (€59,000 versus €39,000 gross value added per employee), demonstrating the continued importance of

scale economies. But the productivity gap has narrowed, illustrating SMEs' increased use of advanced process technologies that permit cost-effective production in small lot sizes. The wage gap between large and small firms has similarly narrowed, signaling SMEs' upward migration in the international value chain demanding highly skilled workers.

The global footprint of European SMEs also expanded during the years preceding the Great Recession. **Exhibit 1** (overleaf) reports exporting activities by enterprise size class in selected EU countries. The data reveals interesting country differences. Micro, small, and medium enterprises collectively accounted for over 60 percent of national exports in Latvia and Estonia. Other small EU countries (Austria, Denmark, Belgium) displayed comparatively high SME export shares. Belgium is noteworthy with respect to the outsized export share (32 percent) of micro-sized enterprises (defined as companies with fewer than ten employees).

But the correlation between size of national economy and SME export share does not hold throughout the sample. Slovenia (whose population is comparable to those of the Baltic Republics) registers one of the EU's smallest SME export shares (32 percent), well below those of large member states like Italy (55 percent) and France (41 percent).

The modest SME export contributions of other small EU countries (Slovakia, Finland, Hungary) suggest that national economic structure—not size of economy—determines the export profile of small and medium enterprises in Europe. In the case of Hungary (19th in size among the EU-27), the comparatively small export share of SMEs (24 percent) reflects the outsized role of large multinational corporations in that country's external sector. Conversely, the export sector of Italy (the EU's 4th biggest economy) benefits from dynamic, internationally oriented SMEs as well as multinational producers of automobiles, machinery, and other manufactured exports.

producing advanced equipment and precision engineered components for automobiles, power transmission, renewable energy, and other global industries. The achievements of Germany's mid-sized export world champions (exportweltmeister) provide valuable lessons for SMEs based in other high-cost Western countries pursuing growth opportunities outside their sluggish home markets.

**SMEs in North America**

The aggregate export of share of small and medium enterprises in Canada (36 percent) is comparable to that of the European Union.

The SME sector of the United States presents a complex and changing picture. Like their European and Canadian counterparts, U.S. SMEs outperformed large companies in job creation. Their adoption of advanced processing technologies and lean manufacturing methods is narrowly the productivity gap with big enterprises. SMEs and technology startups are increasingly vital sources of innovation in the U.S. economy, illustrating their organisational nimbleness and strategic agility.

The exporting activities of U.S. SMEs reveal wide variations by industry (**Exhibit 2 overleaf**). In 2007, export SME shares ranged from 15 percent in transportation equipment to 45 percent in food products. Paper (26 percent), computer products (27 percent), and plastics (33 percent) occupy intermediate positions in the American SME export portfolio. SME exports grew in all of these industries during the pre-crisis period, led by fabricated metals, primary metals, and chemicals.

Unsurprisingly, NAFTA represents the foremost destination of U.S. SME exports. But American SMEs are enlarging their presence in China, which now surpasses traditional European markets (United Kingdom, Germany, Netherlands, France) as an export destination.

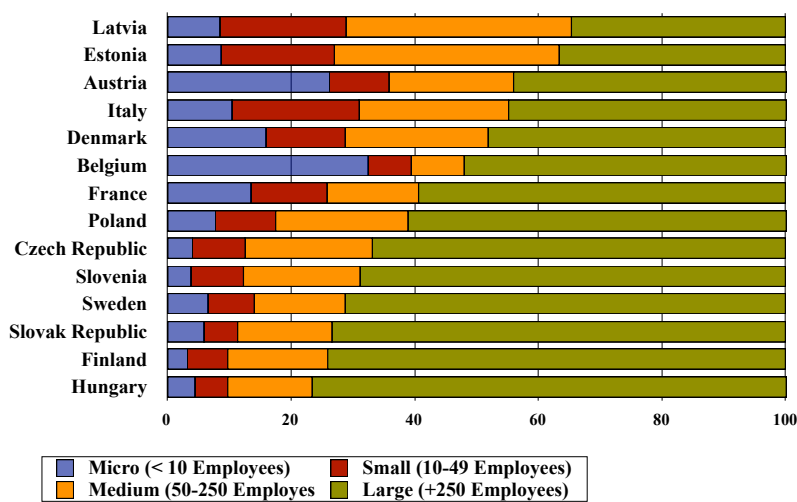
SMEs generate about 30 percent of U.S. exports, lower than the SME export shares of Canada and the EU. SME participation in exporting (around three percent of small and medium enterprises in the United States) is also lower than most other Western countries. Among globally active American SMEs, the top one percent account for over 80 percent of SME exports.

The comparatively low level of globalisation of the U.S. SME sector reflects the huge size of the American economy that weakens the imperative for SMEs to venture outside their domestic markets.

But for the reasons listed, American SMEs facing mounting pressures to go global:

- With weak domestic growth rates on the horizon, U.S. SMEs previously ensconced in their home markets are exploring commercial opportunities in the BRIC countries and other high-growth emerging markets.

**Exporting Activities by Enterprise Size Class in Europe**  
Share of National Exports, Selected EU Countries (Percentage)



Source: European Commission, *Observatory of European SMEs, 2007*; Eurostat, *External Trade by Enterprise Characteristics, 2007*

Exhibit 1

Statistical analyses show that the exporting activities of European SMEs tend to be concentrated in a handful of globally active firms. Just eight percent of small and medium enterprises in the EU engage in exports. Exporting activity is relatively dispersed in Estonia (23 percent of SMEs), Slovenia (21 percent), and Finland (19 percent). But the SME sectors of France and Spain report below-average export participation rates (six and three percent respectively).

Germany (whose export sector flourished in the early- and mid-2000s despite high factor costs and an appreciating Euro) represents a different pattern. The renowned Mittelstand (family owned small and medium enterprises) is the linchpin of Germany's export sector,

But the export profile of Canadian SMEs differs significantly by industry. Large enterprises dominate national exports in scale-intensive industries (mining, extraction, oil and gas). But SMEs hold commanding shares of Canadian exports in agriculture and forestry (80 percent), transportation and warehousing (90 percent), professional services (94 percent), and (construction (98 percent).

As with large companies, the United States and Mexico capture the bulk of SME exports from Canada, demonstrating the allure of the duty-free NAFTA market and the impact of geography on foreign trade patterns. But Canadian SMEs are steadily expanding their activities outside North America, especially the European Union, Japan, and South America.

- The United States hosts a rising number of “born global” technology startups that are immediately hooked into rapidly growing global industries like life sciences and sustainable energy.
- An increasing number of American SMEs are pulled into the global supply chains of downstream multinationals via (1) sales to the foreign subsidiaries of large multinational customers, and (2) manufacture of specialised components for U.S.-manufactured finished goods that find their way to foreign markets. By one calculation, inclusion of SME-produced intermediate goods that are embedded in exported products raises the value-added share of small and medium enterprises to 41 percent.

**Multinational SMEs**

The growing integration of small and medium enterprises into international value chains has given rise to “multinational SMEs”. This organisational form refers to SMEs that are migrating out of conventional exporting and expanding their global operations via foreign subsidiaries.

Multinationalisation of SMEs remains uncommon. In the European Union, only 8.9 percent of small enterprises and 11.9 percent of medium enterprises use foreign subsidiaries versus 25 percent of large companies. Multinational SMEs are even rarer in the United States: Among some six million American SMEs, just 555 have been formally identified by the U.S. Census Bureau as multinational enterprises (controlling one or more foreign affiliate).

But while small in number, multinational SMEs make an outsized contribution to the global activities of small and medium enterprises. The handful of U.S.-based multinational SMEs account for 25 percent of the aggregate foreign sales of American SMEs. A sizable share of these multinationalising American SMEs are foreign-owned, generating export sales by small U.S. companies to their foreign parents.

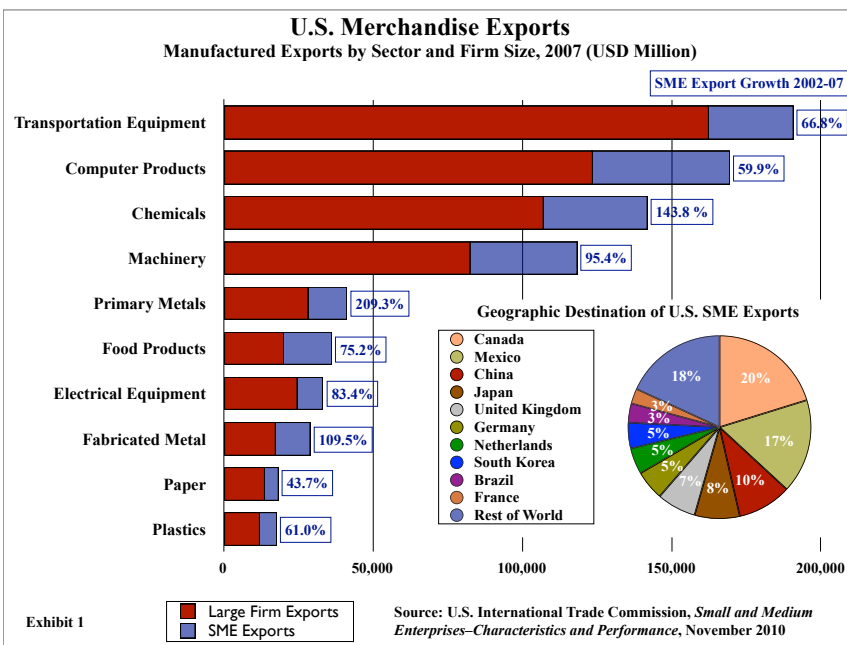
This trend parallels international trade and investment patterns in the large enterprise sector, where intra-company transfers between domestic and foreign affiliates constitute the preferred mode of cross-border transactions by global multinationals.

**Benefits of Globalisation**

Cross-industry analyses in Europe and North America show that globally active small and medium enterprises consistently outperform stay-at-home SMEs: Stronger revenue growth, greater labour productivity, higher wages, faster technology adoption.

The superior performance characteristics of global SMEs reflect a selection bias: i.e., many internationally active SMEs go global because they are already strong performing companies whose competitive assets provide high confidence in their ability to succeed in foreign markets.

But there is also substantial evidence indicating that globalisation strategies create positive feedback effects: Exposure to global competitive pressures incentivizes SME managers to invest in human capital and technology that strengthen their capacity to compete and win in both domestic and foreign markets. Thus, SMEs that choose the global route stand to benefit from a “virtuous circle” of robust growth and rising competitiveness.



#### About RSM International

RSM International is a worldwide member organisation of independent accounting and consulting firms. RSM International is represented in 83 countries and brings together the talents of over 32,500 individuals worldwide. The organisation's total fee income of US\$3.8bn places it amongst the top six international accounting organisations worldwide. Member firms are driven by a common vision of providing high quality professional services, both in their domestic markets and in serving the international professional service needs of their client base.

[www.rsmi.com](http://www.rsmi.com)

#### About David Bartlett

David Bartlett, Economic Consultant, has over ten years' experience of consulting, researching and teaching on international corporate strategy. He specialises in international growth, global manufacturing, foreign sourcing and distribution and corporate risk management.

David is Adjunct Professor of Strategic Management and Organization at the Carlson School of Management, University of Minnesota. He has also held faculty appointments at Vanderbilt University (USA), Yerevan State University (Armenia), and the University of World Economy and Diplomacy (Uzbekistan).

David has received a Fulbright Senior Scholarship, Salzburg Seminar Fellowship and other scholarly awards. He holds a PhD and BA from the University of California and an MA from the University of Chicago.

**E: [david.bartlett@rsmi.com](mailto:david.bartlett@rsmi.com)**

RSM International is the brand used by a network of independent accounting and consulting firms. Each member of the network is a legally separate and independent firm. The brand is owned by RSM International Association. The network is managed by RSM International Limited. Neither RSM International Limited nor RSM International Association provide accounting or consulting services. The network using the brand RSM International is not itself a separate legal entity of any description in any jurisdiction. RSM International Limited is a company registered in England and Wales (company number 4040598) whose registered office is at 11 Old Jewry, London EC2R 8DU. Intellectual property rights used by members of the network including the trademark RSM International are owned by RSM International Association, an association governed by articles 60 et seq of the Civil Code of Switzerland whose seat is in Zug.