

SMES AND GLOBAL GROWTH: THE HIGH-TECH ADVANTAGE



Information and communication technologies, among others, are helping mid-sized companies compete in international markets with established multinationals.

To a greater extent every day, information technology is levelling the playing field for small and mid-sized enterprises (SMEs). Export markets, in particular, are no longer the exclusive domain of large players with the resources to field global sales and production staffs. Today, even start-ups can use the Internet to sell abroad, and to commission foreign firms to produce their designs cheaply.

For some new firms, in fact, geographical boundaries hardly come into play at all: they market and sell to consumers worldwide directly, becoming global players almost from the start. A good example is Skype, an Internet phone service set up by two Scandinavian entrepreneurs in 2003. In short order, Skype grew from a start-up to a global player with US\$2 billion in annual revenues.

Skype is a classic example of a 'micro-multinational', a phrase coined by Google chief economist Hal Varian to describe small firms that acquire a global presence by using technology. However, such instant international presence is more the exception than the rule. Most small companies have to build an international presence the slow way, by building up their brands and creating networks of international business partners. Information technology helps in this effort, but does not produce instantaneous results as it might with specialised communications services providers such as Skype.

Indeed, even technology companies typically need a certain scale and an established brand to expand beyond their home markets. A good example is IceMobile, a Dutch company that creates mobile apps and has launched a successful drive abroad. The firm did so by first establishing its brand in the Netherlands, and then partnering with another Dutch firm with a complementary product—brand loyalty programmes—to expand abroad. Its experience illustrates that, for most mid-sized firms a certain initial size and heft in the home market is a prerequisite for export success.

Broadly speaking, technology has helped to foster three types of SME exporter. First, there are companies such as IceMobile with established brands at home, which can use technology to export their business models. Second, there are so-called 'born global' firms such as Skype, which sell products globally right from the start-up phase. And third, some mid-sized companies use technology to outsource and offshore a core activity.

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VENTURING ABROAD

Although technology is fostering a new generation of smaller, export-focused companies, this development should be seen in perspective. Most SMEs remain focused on their home markets and have no plans to venture abroad anytime soon. This is particularly true of SMEs based in large markets such as the United States. US statistics show that 304,000 out of the country's 5.8m companies—only 5.5% of the total—exported in 2014.¹ Moreover, most of those exports went to neighbours Canada and Mexico. "The domestic market is big enough to grow sales in by itself, and small companies often lack the resources to export," explains Erin Butler, a commercial officer of the US Commerce Department's Export Assistance Centre in New Orleans.

Most European SMEs focus on their national markets, too, despite the advantages of the European single market. Only about one-fourth of continental European companies trade internationally, according to the Confederation of British Industry (CBI). In fact, the figure is driven upwards by Germany, where more than half (54%) of all manufacturing companies export, according to the Deutscher Industrie- und Handelskammertag (DIKW), an industry body. In the Netherlands, a big trading country, around 20% of firms export, often as suppliers to local multinationals, says the Dutch business federation MKB.

Similarly, France has comparatively few exporting companies, with foreign trade dominated by a relative handful of large firms. In a recent survey, United Parcel Service, the world's largest package delivery company, found that only 10% of French companies export.² French government figures show there are only 120,000 French exporting companies, a third of the number in Germany. In the UK, just 8% of companies export directly, and another 7% supply foreign markets indirectly as part of multinationals' supply chains, the CBI says

Yet there is evidence that the Internet is changing this picture, encouraging more SMEs to look abroad for growth. For example, Petit Bateau, a privately-owned French children's clothing company with 2013 sales of €300m, now sells successfully to other European countries over a website launched in 2006. The web site built upon an international chain of shops started by Petit Bateau in 2001, which, in turn, built on a mail-order business the firm started in the late 1980s. The web site, in short, enhances the firm's international offering, but is not the basis for it. The basis is a fashion business that was developed over decades in the home market, and then expanded through mail order and traditional bricks-and-mortar shops.

Similarly, the director of a successful UK fashion brand, which now earns around half of its £380m annual revenue in foreign markets, expects explosive growth from Internet sales—but sees this growth as building on the firm's existing brand strength. "The Internet technology became available for us to increase our presence abroad around six years ago," says an executive of

¹ United States Census Bureau 2014 <http://www.census.gov/programs-surveys/susb.html>

² https://www.ups.com/media/news/en/gb/European_SME_Exporting_Insights_Study_2015.pdf

SMES AND GLOBAL GROWTH: THE HIGH-TECH ADVANTAGE

the firm, who requested anonymity. The web site automatically detects where a user is based, enabling options such as home delivery or “click and collect” at a local store.

As with Petit Bateau, these marketing channels complement, rather than replace, an established foreign presence. The UK firm opened its first foreign store in the US in the late 1990s, and then steadily built up a network of shops worldwide, as well as supply arrangements with foreign department stores. As these examples show, the companies that benefit most from leveraging their established brands via the Internet are often those occupying a specialised market niche, such as a fashion brand or a unique technology.

‘BORN—OR RE-BORN—GLOBAL’

Many ‘born global’ companies, in contrast, sell a high-technology product internationally right from the start. As noted above, Skype and social media platforms such as Facebook fit this description. Another example is Bausey Medical Solutions, a US firm marketing a medical diagnostic app. The firm says it has attracted interest from Europe as well as the US. In Germany, start-ups such as SoundCloud, a global online audio distribution platform, and the photo-editing and photo-sharing app EyeEm, have quickly built a global presence.

In some cases, the growth afforded by Internet marketing is so rapid that a company is, in effect, ‘re-born global’. IceMobile, for example, built an established national presence by providing mobile apps for Dutch companies such as ABN Amro bank and the Albert Heijn grocery store chain. It then proceeded to build an international presence. In 2012 it merged with another Dutch company, BrandLoyalty, which produces loyalty programmes for retailers. Most of its revenues now come from foreign markets, as the combined company uses IceMobile technology to offer shoppers mobile access to their accounts. Clients include companies such as Lowes Foods (US), Dutch-owned SPAR China, and Danish retailer Coop, says its chief executive Jeroen Pietryga. “The possibilities are increasing fast,” he adds, pointing to the possible use of customer data to design and implement loyalty schemes.

Similarly, Globalstar, a listed US communications company, grew quickly in international markets after making major technology investments. “It cost us US\$1bn to launch our satellite network,” says Jay Monroe, Globalstar’s chairman, with industry backers including Deutsche Aerospace and Vodafone funding the launch of a system that supports satellite phone and data transmission. That investment enabled the company to occupy a niche selling global positioning and tracking devices, including satellite phones for individuals visiting remote regions.

Mr Monroe talks of bringing the retail price down to US\$100 (less than half of the launch price at the start of next year). “The potential market could be 500,000 units a year in time,” he claims,

SMES AND GLOBAL GROWTH: THE HIGH-TECH ADVANTAGE

with interest from the major car makers (looking for reliable connectivity for their vehicles) as well as retailers. That would be a large increase for a company with 2015 revenues of US\$90.5m. The potential is being factored into its share price: the company is valued at more than US\$1bn. Like IceMobile's, Globalstar's experience shows that technology companies can tap into global markets to win rapid growth, but must have an initial scale and established technology to do so.

OUTSOURCING AND OFFSHORING A CORE ACTIVITY

Mid-sized companies can also expand abroad in a third way: outsourcing a core activity, such as manufacturing, to a foreign partner, using information technology to ensure close adherence to product specifications and guidelines. Mid-sized manufacturers based in Germany in particular have led the movement to move manufacturing to lower-wage partners in Asia and Eastern Europe. In many cases, such moves are in response to technology-driven offshoring of production by the SMEs' key multinational customers.

This pattern is well established, and predates the Internet revolution. Many German mid-sized firms set up production in Asia as they followed their multinational customers there; leading automakers, for example, have been manufacturing in China since the 1980s. The German Chamber of Commerce says that more than 5,000 German firms now operate in China and that, with local production so well established, attention has shifted to exploiting the huge Chinese market. By now, 93% of German firms say that they are in China for its sales potential, while just 43% are there because of lower production costs.

The shift wrought by information technology is not that it allows firms to outsource or offshore core activities, but that it makes it much cheaper and easier for smaller companies to follow the lead of bigger companies in doing so. A good example is Bowers & Wilkins, a UK company that produces loudspeakers and other audio equipment. Three quarters of its £125 million annual revenue comes from a plant it opened in China to cut costs. That plant allowed it to market speakers priced at just a few hundred pounds, compared to the £35,000 price of some of its UK-manufactured systems (or up to £1 million for a bespoke stadium system).

Beyond facilitating offshoring, the Internet combined with technologies such as 3D printing and automated manufacturing are changing the nature of manufacturing itself. A case in point is Local Motors, a US company that uses open-source online vehicle designs and then manufactures the vehicles through a global network of small plants, sometimes through 3D printing. The firm employs just 15 full-time staff, relying on an online network of 12,000 freelance designers. To date, it has produced about 50 off-road vehicles, and plans to produce another 1,500. Its combination of open-source design and distributed manufacturing allows this mid-sized firm to compete with automotive giants burdened with large fixed costs.

SMES AND GLOBAL GROWTH: THE HIGH-TECH ADVANTAGE

A LOOK AHEAD: CONSTRUCTIVE DISRUPTION

Examples such as Local Motors show how new technologies that benefit SMEs also disrupt established business models across a range of industries. In manufacturing, a shift to flexible manpower and online intellectual property is calling into question the old fixed-plant business model, which requires mass manufacturing to benefit from economies of scale.

Moreover, highly automated production—for example, the use of robots—will eventually erode the cost advantage of basing production in low-wage countries, as labour becomes less important to costs, says Erik Brynjolfsson, a professor of management at the MIT Sloan School of Management and director of the MIT Initiative on the Digital Economy. This will allow mid-sized firms to shift production away from low-wage countries and into target markets abroad, or indeed back to their home markets to facilitate close monitoring of quality and product design.

Rossignol, the French ski equipment maker with 2015 sales of €243m, provides an example of 'backshoring'—moving previously offshored production back to the home market—as the cost advantage of offshoring was eroded. The company said in 2010 that was moving production back to France that it had off-shored to Taiwan three years earlier. Its aim, it said, was to produce better researched products and react more quickly to changes in the ski equipment market. Modern manufacturing technology has helped to protect the company's price-competitiveness despite its return to a higher-wage manufacturing base.

Non-manufacturing industries also provide examples of business-model disruption driven by new technologies, which in turn opens new opportunities for SMEs to challenge established giants. In financial services, small players are building new markets in developing countries by offering basic, mobile-based banking services to previously under-served populations. An example is bKash, a mobile banking platform in Bangladesh. It launched in 2011 and had 11m accounts two years later. In retailing, small web-based shopping platforms such as Konga and Jumia in Nigeria are challenging the predominance of companies like US-based amazon.com, and have seen rapid growth in their customer bases as well. Jumia was launched by a German e-commerce investor, Rocket Internet, in 2012. It is losing money, but its sales have surged to US\$150m a year.

Across manufacturing and service industries, then, technology is not just enabling leaps in efficiency. It is changing the very way that some sectors operate. For mid-sized firms, this opens the door to explosive growth, if they are able to spot and exploit new market niches, and use new technologies to leverage their success.