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From exports to foreign investments: SMEs tap into foreign markets

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Small and medium-sized enterprises take small steps on their path abroad. They begin by exporting to neighbouring Western European countries and then expand to more distant sales markets such as Asia. Ultimately this export experience paves the way for foreign direct investments (FDIs). This result is highlighted in a recently published KfW Study on the internationalisation activities in the SME sector.

The study also shows that companies' are well-advised to follow such a step-by-step strategy: It significantly increases their probability of succeeding abroad.

If enterprises shy away from exports, FDIs are unlikely

Foreign direct investments are associated with considerably higher costs and greater risks – which is why only 30 % of exporters have made FDIs. SMEs that have years of extensive experience exporting, invest more frequently abroad.

An enterprise with a low export ratio (5 %) has only a 9 % likelihood of becoming a foreign direct investor. In contrast this doubles to 19 % in case of enterprises with intensive export experience (export ratio: 40 %). Thus, exporting not only opens the doors for FDIs, it increases the probability of FDIs substantially.

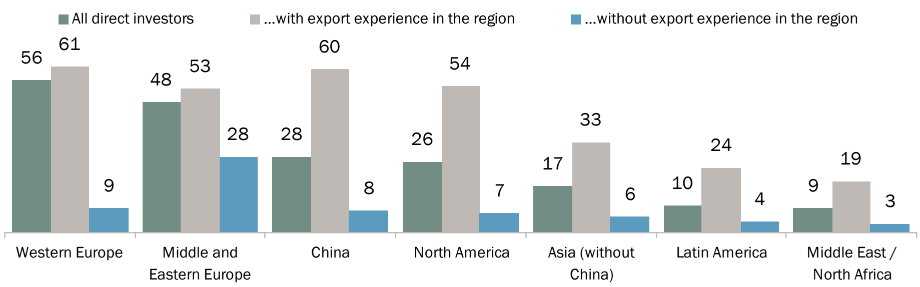
This correlation holds globally (Chart 1): On average across all target regions SMEs are 6 times more likely to make an investment if the region in question is already known to them through previous export activities (compared to a situation without regional export experience). This difference is more pronounced for geographically and culturally distant markets such as North America (7.7) and China (7.5 times more frequently).

Export experience has a positive impact on the success of FDIs

Apart from the willingness to invest abroad, the probability to succeed in a foreign market depends on export experience. Foreign direct investments are discontinued 4 times more frequently than export relations. If a company lacks export experience the likelihood of withdrawal from a FDI is 36 %, otherwise it is only 8 % (Chart 2).

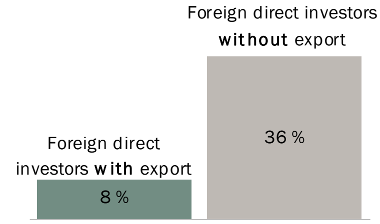
Chart 1: Frequency of direct investment depending on export experience

Share of enterprises with direct investments in the target region in per cent



Source: KfW-/Creditreform survey from 2012.

Chart 2: Withdrawal frequencies



Source: KfW-/Creditreform survey from 2012.

Accessing new markets is the main motive for FDIs

Foreign direct investments currently focus primarily on tapping into new sales markets or expanding presence in existing sales markets (78 % of investors). Cost-driven FDIs are of secondary importance (42 %). Since expanding sales markets tends to increase domestic demand for labour, FDIs are likely to have a positive impact on employment in Germany.

Barriers must be eliminated early on

On their way abroad, SMEs are pursuing a strategy of small steps. This allows them to test the waters in foreign markets and prepare for FDIs. In addition, the joint study of KfW and Creditreform shows that this strategy is a promising one over the long term.

One important implication following from the study is that obstacles on the way abroad must be removed at an early stage of foreign market activities. If an enterprise chooses not to export, then an eventual FDI is less likely. Therefore, the early mobilisation and support of SMEs as they enter into business abroad is important.

KfW-/Creditreform Survey "Internationalisation in Germany's SME sector – step by step to global presence".