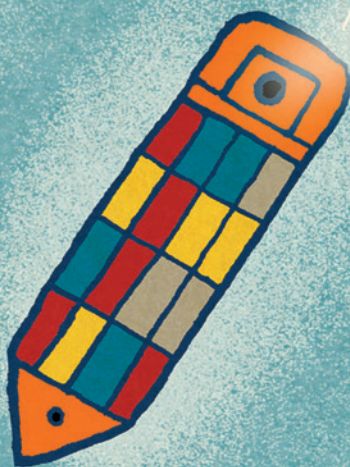


# Breaking borders

From Canada to China, barriers  
overshadow growth for expanding SMEs

A report from The Economist Intelligence Unit



Commissioned by





# Contents

<b>About the report</b>	<b>2</b>
<b>Executive summary</b>	<b>3</b>
<b>Introduction: The ‘growth’ conundrum</b>	<b>5</b>
<b>Chapter 1: Deciding where to grow</b>	<b>6</b>
<i>Case study: Russia’s Izbenka—perfecting home base</i>	7
Rich man’s world	8
<b>Chapter 2: What is getting in the way of growth?</b>	<b>9</b>
Infrastructure challenges	9
Politically motivated	10
<i>Case study: Japan’s Cerevo—staying nimble and unique</i>	11
<b>Chapter 3: Investing in Africa—the final frontier or forlorn hope?</b>	<b>12</b>
Getting the numbers right	13
<i>Case study: UK’s BuffaloGrid—building a mission-driven business</i>	14
<b>Chapter 4: Investing in China—too big to fail?</b>	<b>15</b>
Think local, stay global	16
<i>Case study: Canada’s Clevest—partnering with government</i>	17
<b>Conclusion: Striking the balance</b>	<b>18</b>



## Breaking borders

From Canada to China, barriers overshadow growth for expanding SMEs

# About the report

*Breaking borders: from Canada to China, barriers overshadow growth for expanding SMEs* is an Economist Intelligence Unit (EIU) report sponsored by Deutsche Post DHL. The report strives to identify the key issues that small and medium enterprises (SMEs) grapple with as they expand internationally—which for many firms can outweigh the promise of growth—and to outline how companies have successfully resolved these challenges.

This report draws on two main sources for its research findings.

In May–June 2014 the EIU surveyed 480 SMEs across the world, with 40 respondents representing each of the following countries: US, UK, France, Germany, Italy, Canada, Japan, Brazil, Russia, India, China, and Mexico. In all, 20 sectors were represented, including real estate, consumer goods, financial services, information technology, manufacturing, professional services and telecom. More than half of the SMEs involved in the survey reported between US\$500,000 and US\$5m in annual revenue, while one-third reported between \$5m and \$20m. A minority of respondents booked up to \$70m a year.

Alongside the survey, the EIU conducted a series of in-depth interviews with the following senior executives and experts (listed alphabetically by organisation):

- Daniel Becerra, managing director, BuffaloGrid
- Takuma Iwasa, CEO, Cerevo
- Mark Hedley, China business adviser, China-Britain Business Council
- Thomas Ligocki, president, CEO and chairman, Clevest
- Peter Millar, VP of product marketing, Clevest
- Dickson Lai, CFO and company secretary, Hosa International Ltd
- Andrey Krivenko, founder, Izbenka
- Danielle Walker, director of African affairs, US Chamber of Commerce
- Viral Desai, managing director, Zenitex Pvt Ltd

The report was written by Joseph Chaney and edited by Charles Ross. We would like to thank all interviewees and survey respondents for their time and insight.



## Executive summary

The important role SMEs play in global economic development cannot be overestimated, given that small companies provide the majority of employment opportunities worldwide. Yet, today, SMEs are facing the same macroeconomic pressures as bigger businesses, and are struggling to find their niche within a rapidly globalised business environment. Gone are the days when ambitious SMEs could sit back and simply own a slice of their home markets. Now they must think about the world at large, and engage a range of clients, suppliers, and contractors in multiple countries to survive.

Expanding internationally does not come easy, however. SMEs across a range of industries – from financial services to retail – face a number of obstacles as they plan their international trade strategies, including unreliable infrastructure, prohibitive set-up costs and unstable politics. Contrary to conventional wisdom, these problem areas often outweigh raw growth potential in importance as SMEs formulate their expansion plans. In fact, in many instances SMEs conclude that growth simply won't be possible without certain standards governing the target market's operating environment.

*Breaking borders: from Canada to China, barriers overshadow growth for expanding SMEs* is an

Economist Intelligence Unit (EIU) report, sponsored by Deutsche Post DHL. The report analyses the key issues that SMEs face as they expand internationally. It draws on the results of a survey of 480 SMEs spread across 12 countries and 20 industries, and interviews with senior SME executives and officials from business lobbying groups.

Some of the key findings from the report include the following:

- **The majority of SMEs see international trade as vital for their survival, despite the risks and costs associated with expansion.** While 40 percent of respondents currently earned zero revenue from international operations, a clear majority expect to derive between 11 and 50 percent of their revenues internationally in five years' time. Nearly 69 percent of the G7 respondents currently trade internationally whereas only 46 percent of respondents from Brazil, Russia, India, China, and Mexico (BRICM) do. Yet, a majority of all respondents agreed that international trade was vital to their survival, with broader client bases and stronger revenue topping the list of trade benefits.
- **Companies see growth opportunities internationally – but the challenges of entering new markets are a bigger concern.** Across



## Breaking borders

From Canada to China, barriers overshadow growth for expanding SMEs

developed and developing markets, SMEs are focused on potential problem areas that trump growth in terms of importance. These include the quality of a target market's infrastructure, the stability of its politics, the administrative costs of establishing a local presence, familiarity with the market's culture and the accessibility of local business acumen and networks. While concerns about political stability and patchy infrastructure tend to be more pronounced in developing markets such as Africa, the relative certainty of more established markets can come at a higher price, especially in terms of wages and compliance.

● **The vast majority of SMEs expand into markets that are similar to their own.** Given the risks of expansion, most SMEs with international operations have those operations in markets that resemble their own. Compared to their G7 counterparts, SMEs from BRICM have a much higher presence in other developing countries. For example, 15 percent of BRICM SMEs have international operations in Russia and CIS, whereas only 3.6 percent of G7 SMEs do; 18.5 percent of BRICM SMEs have international operations in South America compared to only 4.6 percent of G7 SMEs.

● **Tapping into established local networks is a good way to limit the costs of expansion.**

Near the top of the SME investment checklist is the ability to tap into established networks and find reliable distributors in overseas markets. Rather than establish operations or joint ventures abroad, many ambitious G7 SMEs prefer to work with distributors, resellers and other companies with established networks to keep their costs down as they fight to gain traction in a new market. G7 SMEs that are actively seeking partnerships with foreign companies tend to feel less equipped to incur excessive administrative costs, suggesting companies with strained budgets look to partners to share the burden.

● **As far as developing markets go, China is the most attractive whereas Africa is the least alluring.** For expansion-hungry SMEs, no two markets are treated as differently as Africa and China. Both geographies are high-growth stories, earning headlines worldwide for their enormous potential. Yet, despite Africa's strong growth rates the vast majority of survey respondents see very few opportunities in the region. China, however, remains a magnet for SME confidence and investment, given the country's commitment to infrastructure improvements and its capacity for streamlined decision-making, however undemocratic it may be.



## Introduction: The 'growth' conundrum

Economists and politicians often claim that small and medium enterprises (SMEs) are the backbone of economic vitality, providing the vast majority of jobs and services around the world. To be sure, the numbers don't lie. According to the International Finance Corporation, SMEs account for about 90 percent of businesses and more than 50 percent of employment worldwide. Although the impact and influence of SMEs varies on a country-by-country basis, as a group they are vitally important growth engines in both developed markets such as the UK and the US, and developing markets such as Brazil, Russia, India, China and Mexico.

Today the forces of globalisation—rapidly accelerating on the back of closer trade agreements and increased connectivity—are reshaping the growth ambitions of SMEs. Our global survey shows that most small companies are no longer content to only serve their home

markets. In fact, the vast majority of survey respondents expect to derive 11 to 50 percent of their revenues internationally in five years' time and see international trade as vital to their survival. Staying home and leveraging company balance sheets to only one market—with the exception of having a clear strategic reason for doing so—is considered a risky proposition.

Yet, SMEs across the world—from tech companies to textile manufacturers—say that international growth often comes at a significant cost. Sometimes the price is too high. Case in point: most SMEs feel there are few opportunities in Africa, despite the continent's status as one of the world's largest potential growth regions. As this report will show, expanding abroad brings with it a whole new set of obstacles to overcome before the lure of overseas growth can be realised.





## Breaking borders

From Canada to China, barriers overshadow growth for expanding SMEs

# 1

## Deciding where to grow

### Top SME strategic considerations

#1: Cultural compatibility

Over the past few decades, goods and services have flowed across borders like never before, with exports increasing fivefold in the last 24 years alone. (Figure 1) Much like larger corporations, SMEs are harnessing these forces to the benefit of their own balance sheets, outsourcing services and production to an interwoven chain of suppliers from China to Mexico to India.

Yet, despite these trends, SMEs are still by and large more active in markets that resemble their own: compared to their G7 counterparts, SMEs from BRICM markets are more likely to seek growth opportunities in other developing countries, while SMEs from the G7 economies are more active in other developed markets. That many G7 SMEs are not aggressively expanding in developing markets—where most of the

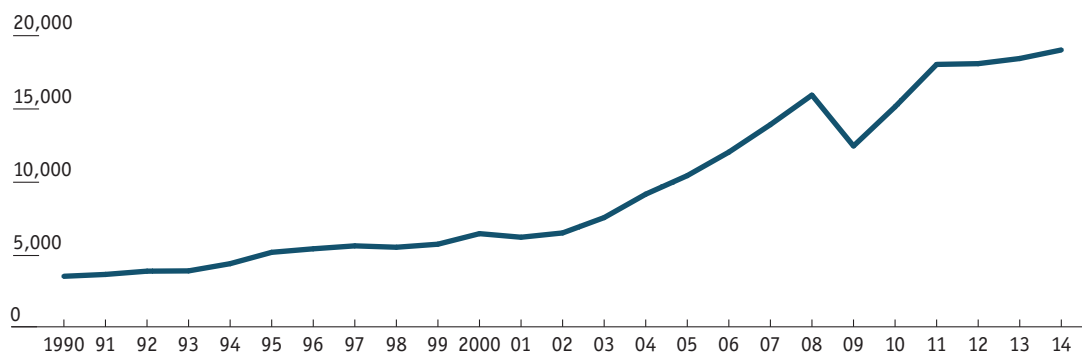
macroeconomic opportunity resides—illustrates the extent of their concerns about the risks of investing time and resources in unfamiliar terrain.

Cultural compatibility obviously plays a part here, especially if the SME's home country has a particular or well-established business etiquette that doesn't easily translate in different geographies. "For Chinese companies, the whole board and manufacturing base is in China, so they are quite familiar with the Chinese culture," says Dickson Lai, company secretary and CFO for Hosa International Limited, a Chinese producer of mid-to-high end sportswear. "But the language and the culture is much different from Europe or the Middle East, so that is a major obstacle—that is why we prefer Asian countries."

Figure 1: Relentless rise in trade

### Total world exports

(US\$b)



Source: The Economist Intelligence Unit



## Case study: Russia’s Izbenka—perfecting home base

Top 3 reasons for success:

- \* Focus is on high quality local products not offered by many other suppliers
- \* Knows its destiny: accepts that not every company will be a global giant
- \* Isn’t in a hurry to grow abroad; aims to corner home Moscow market first

Although the majority of survey respondents say that international trade is vital to their survival, there are some ambitious 21st century SMEs that aren’t seduced by the expansion frenzy, and instead commit to perfecting their business at home before they even consider investing abroad.

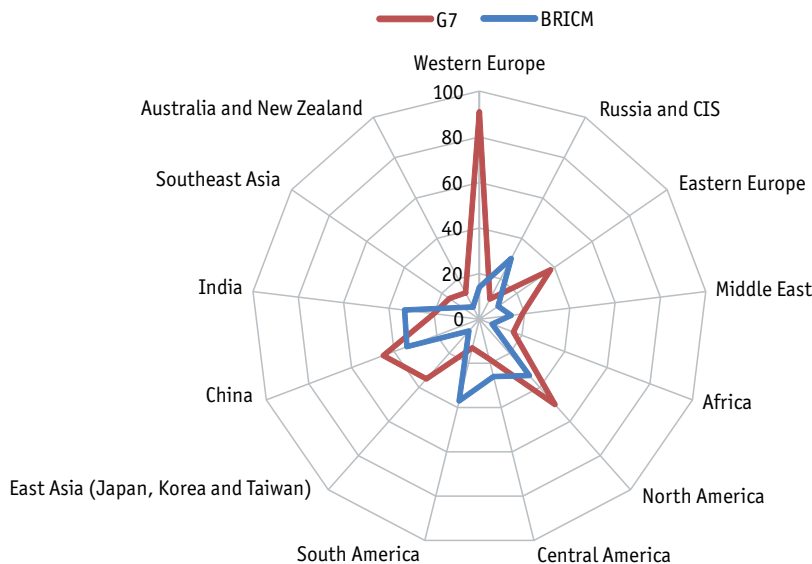
Russia’s fresh milk success story Izbenka is one such company. Andrey Krivenko, former CFO of fish and seafood distributor Agama Trade, founded the company after he resigned from

his job in 2008 and was unable to find new work. Within three years Izbenka emerged as Russia’s largest fresh dairy produce vendor and reportedly racks up nearly \$60 million in annual turnover due in part to the firm’s asset-light operating model—the company leases all warehouses, and outsources transportation, according to a recent media profile in *Russia Beyond the Headlines*.

“In the next five years we are not planning to penetrate foreign markets,” says Mr Krivenko. “Now we deal only with the Moscow region and even do not plan to go outside that region. We are still refining our service. We’ve not yet found a format—product shops like Ikea, Auchan, etc.—that would be in demand once opened in international markets. So the main factor for us is to be sure that our natural products for health nutrition are needed by people.”

Figure 2: Rich and poor heading abroad

Overseas operations of G7 and BRICM companies  
(% respondents)



Source: The Economist Intelligence Unit





## Breaking borders

From Canada to China, barriers overshadow growth for expanding SMEs

That's not to say BRICM SMEs don't aspire to expand into G7 markets. Over 46 percent of BRICM SMEs see Western Europe as either a moderate or high growth market, and a majority say the same about North America. In fact, as potential target markets, those economies are considered far more attractive than certain developing markets such as Africa. Still, more than 32 percent of G7 SMEs have operations in Western Europe versus just 7 percent of BRICM SMEs, signalling that the costs of operating in developed markets—a common complaint from all survey respondents—are especially prohibitive for SMEs from developing countries. (Figure 2)

Viral Desai, managing director of India-based textile supplier Zenitex, frames his company's preference for developing markets in terms of costs and benefits—in his view, each dollar spent in a developing market generates a better overall return.

"In developing nations, it is comparatively easier to allocate and justify investment to start or expand international activity," Mr Desai says. "Also, it may be difficult to insure products for foreign markets or assets in developed countries. Furthermore, in developed countries, one can expect more difficulty in maintaining a competitive advantage due to the more complex and intensive competitive environment compared to developing nations."

## Rich man's world

For many SMEs from developing markets, the costs of doing business in more developed and highly regulated economies are simply too high, despite the obvious legal stability and transparency standards that such economies provide. It can be easier to get started and launch a new business in markets that lack firm legal frameworks and operational protocols.

"Our model in China is quite similar to other

developing markets," says Mr Lai. Hosa currently derives only five percent of revenue from markets outside of China including the Middle East and other Asian countries; they expect that business to grow to 15 percent of revenue in five years' time.

"For developed countries the rules are quite strict—they have higher fees, such as the operating licence and the costs of forming joint venture partnerships," says Mr Lai. "In addition to cost-related concerns, the business cultures and accepted best practice behaviours of developed markets are often incongruous with developing market SME operating models."

To SMEs based in G7 economies, costs and benefits are calculated using the reverse equation: the stability and predictability of developed markets is often valued more than the risk and reward profiles of high-growth economies. "On one level, of course it's more comfortable to be dealing with a country that has a similar approach and a certain level of stability," says Thomas Ligocki, president, CEO and chairman of Canada-based Clevest, which sells mobile workforce and smart grid software solutions to gas, water and electric utilities companies across North America, Latin America and China, among other geographies.

According to Mr Ligocki, analysis of a target market's business practices is best conducted on a sector specific basis. Some sectors are more vulnerable to the unpredictable political and economic gyrations of developing markets, while other sectors—in Clevest's case, utilities—are more insulated due to their role in the economy. "Even for countries that have defaulted on their debt, utilities still have to operate," Mr Ligocki says, adding "If they turned off electricity all of a sudden they'd have a revolution on their hands. Utilities happen to be a stable part of any economy."



# 2

## What is getting in the way of growth?

As SMEs decide where to allocate expansion capital, they are evaluating a list of market characteristics that outweigh the importance of growth, according to the majority of survey respondents. At the top of this list is the ability to tap into established networks and find reliable distributors in overseas markets. Rather than establish operations abroad, many ambitious G7 SMEs prefer to work with distributors, resellers and other companies with established networks to keep their costs down as they fight to gain traction in a new market.

“The biggest thing we need when we’re looking at countries is partnerships, because we are deploying our services in remote communities,” says Daniel Becerra, managing director of the UK’s BuffaloGrid, which deploys solar powered mobile phone chargers to rural communities in Africa, Southeast Asia and India (see BuffaloGrid case study). “We don’t have the resources to find these remote communities, so we need to find a partner that has that network.”

The use of existing networks is also valuable to SMEs working in urban environments and more mainstream industries. “We send our staff to do business development trips,” says Mr Ligocki of Canada’s Clevest, which is considering an office in China but has yet to take the leap given the costs. “But our primary focus is on partners. In this industry it takes a lot to develop relationships, and the sales cycle is fairly long, so it’s better for us to get to know a partner who has spent

many years getting to know the end customers and forming that level of partnership with them. That’s our primary effort—to find partners in all of these markets.”

### Infrastructure challenges

Linked to the challenge of tapping into established networks is another, equally daunting, problem area: finding attractive markets that also have reliable infrastructure and stable political environments. Over 90 percent of BRICM SMEs that expect to derive more than 10 percent of revenues from international trade in the next five years believe the quality of IT and communications infrastructure to be either important or very important to the appeal of an international market; over 80 percent of their G7 counterparts agree. The percentages that see political stability as important are in the same range.

“While entering the new market, procedural as well as maintenance costs should definitely be well calculated and considered before venturing into it,” says Mr Desai from India-based Zenitex.

“Besides routine formalities,” Mr Desai adds, “there is a whole host of other costs that may arise, including: divergent interpretations of customs valuation rules by different customs administrations, including the use of arbitrary or fictitious customs values; delay in customs clearance procedures –such as excessive irrelevant paperwork, congestion at points of

#### Top SME strategic considerations

#2: The presence of local networks and business acumen

#### Top SME strategic considerations

#3: The existence of reliable infrastructure



## Breaking borders

From Canada to China, barriers overshadow growth for expanding SMEs

entry, delay and cost of cargo clearance; lack of procedures for prompt review; and lack of transparency or irregular and illegal practices—such as unofficial customs procedures, unwritten rules and unpublished changes, unofficial fees to accelerate processing, and the absence of information on customs regulations and procedures in English.”

Reliable delivery channels and stable policies are required to sustain a business, even for companies focused on selling services to rural communities. “If someone comes along and says I’m in Haiti and I want to set up BuffaloGrid, the first thing that I need to tell them is that we need an organisation, a company, a government entity that has penetration in rural communities that can help us deploy our units in those places,” says Mr Becerra. “That’s our first challenge—being able to find a way into the communities.”

### Top SME strategic considerations

#4: The stability of a market’s political environment

## Politically motivated

No matter how stable the infrastructure, however, all of it may be for naught when contaminated by unstable politics. “We’re very close to closing a deal in a country in Latin

America, but the country has defaulted on its debt,” says Thomas Ligocki from Clevest. “That creates an issue—not that the utilities will go bankrupt—they won’t. But all sorts of issues arise in a scenario like that. Issue two is that when we get paid, the country may not allow you to take money out of the country.”

Of course, there are always exceptions and outliers—SMEs that profit from situations that harm other companies. Depending on the industry, some SMEs may benefit from a certain degree of political turmoil if their products strive to bring clarity to messy situations. The important and highly visible role social media and broadband connectivity played in the Arab Spring is just one recent example of a particular industry category benefiting from upheaval. “We don’t care whether politics are stable or not,” says Takuma Iwasa from Cerevo. “Our most famous product is an internet live video streaming device. These devices are very suitable for countries with unstable politics. [The device] isn’t a gun or a missile, but it’s an important weapon of citizens to broadcast their opinions.”



## Case study: Japan's Cerevo—staying nimble and unique

### Top 3 reasons for success:

- \* Sells high-end and unique consumer electronics to niche customer base
- \* Asset-light operating model: uses trade shows and distributors to grow in new markets
- \* Stays concerned about customer service, despite some reliance on resellers

Cerevo began life in Japan in 2008. Until the end of 2011, all revenue came from the company's domestic market. However, international expansion and the opening of an office in the US occurred quickly. Just a few years later in 2012, around 40 percent of revenue came from international sales. Today the company books sales in roughly 25 countries, both developed and developing, including the US, the EU, the Dominican Republic, Slovenia, Bosnia and Herzegovina, and South Korea, among others.

"We only have 15 employees," says Mr Iwasa, emphasising the company's nimble operating model. "Currently we don't choose markets. We just exhibit at international trade shows and

open the window to distributors from different countries. Once we are contacted, our sales team starts a discussion. That may be passive, but it's very suitable for a small company like us."

While the nimble model has its perks, quality control over resellers remains a challenge and can potentially damage a company's brand, Mr Iwasa adds. For example, because the company's products contain complex software, it prefers to receive returns itself to try to address problems rather than have them go back to resellers, but the logistics in some markets mean that doesn't always happen.

Despite these challenges, Mr Iwasa remains confident that growing via distributors and resellers can work over the long term. "Our company is focused on niche hardware inside complex embedded software. That's difficult to develop, but all over the world niche users are looking for suitable products for the web, including SNS (social networking services). These products easily penetrate the global market without huge sales and promotion costs."



## Breaking borders

From Canada to China, barriers overshadow growth for expanding SMEs

# 3

## Investing in Africa—the final frontier or forlorn hope?

Despite Africa's strong growth rates—set to reach 5% in sub-Saharan Africa in 2015 on the back of investment growth and household spending (Figure 3)—the vast majority of survey respondents see very few opportunities in the region. Roughly 40% of both G7 and BRICM SMEs that are planning to trade internationally in the future said the continent offers no growth potential, indicating that the negative impression is set well before SMEs even establish offshore operations. (Figure 4)

“US SMEs entering Africa are spending a lot of money dealing with inadequate infrastructure,” says Danielle Walker, director of African affairs at the US Chamber of Commerce. “There are high costs associated with deliveries waiting in stifling traffic and sitting at border crossings because of inefficient customs procedures. SMEs

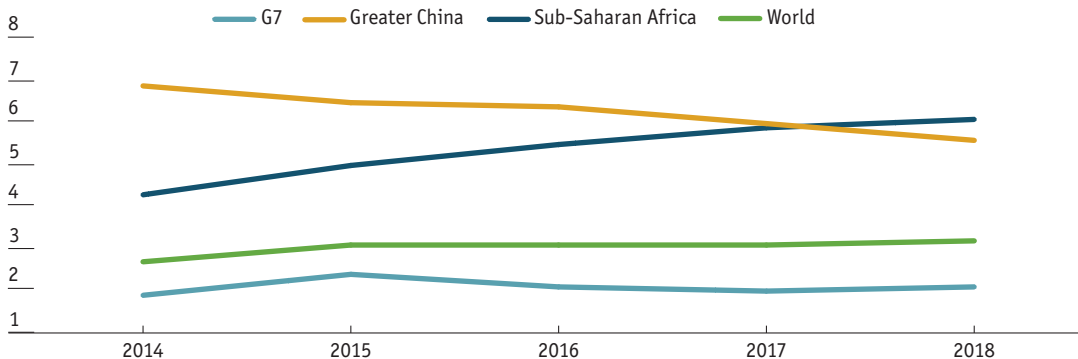
are purchasing back-up generators because of inconsistent power supply. Their employees likely have several mobile phones from different providers, because of unreliable network coverage. If an SME is unable to hire locally because the skill set is not readily available in market, it can be very expensive in terms of taxes to bring in an American to do the work, as South Africa is the only country in sub-Saharan Africa that has a double taxation treaty with the US.”

Although numerous macroeconomic signs and trends point to an economic resurgence, the continent has not made significant strides in the crucial areas of technological development and infrastructure, and it continues to struggle with a host of public health challenges, from Ebola outbreaks to the AIDS epidemic.

Figure 3: Africa leading the way in growth

### Projected GDP growth

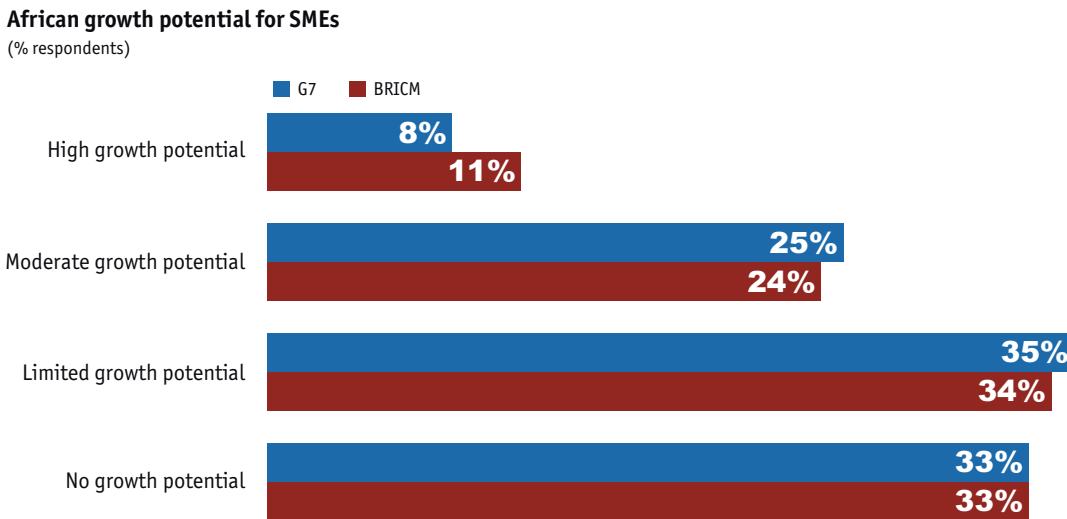
(% real change pa)



Source: The Economist Intelligence Unit



Figure 4: Afraid of the African opportunity



Source: The Economist Intelligence Unit

SME doubts over Africa are linked, with the exception of South Africa, to a simple lack of information about the macroeconomic situation on the continent as a whole, as well as the details—both real and perceived—that distinguish each individual African economy and society. “It has to do with the number of market data points we have,” says Peter Millar, VP of product marketing at Canada’s Clevest. “While we do see some data points coming out of Africa, we see some indicators that it would be a very long slog to actually make a profit. At some utilities in Africa, three-quarters of the power is lost, at best. It’s not actually a good and stable environment to invest in new technologies, when they don’t even have the basics down.”

For companies selling computer and Internet-related products and services, Africa’s problem is first and foremost technological—the continent simply lacks the necessary infrastructure to support hi-tech electronics. “Our products need high-speed Internet connections so it’s too early to start an African business, which needs reliable Internet connectivity,” said Mr Iwasa.

Mr Becerra of BuffaloGrid—which launched its first offering in Uganda and is deeply familiar with the dynamics on the continent—concurs with that assessment, adding that petty corruption is also an issue. “The concerns are certainly valid,” Mr Becerra says. “For instance, on my second trip to Uganda I met these doctors from the US and they were telling me how a container full of medicines had been stuck in customs for three months just because someone thinks he can get money from someone—so that’s the reality.”

### Getting the numbers right

Yet another challenge for companies trying to sell a compelling service or establish a prestigious brand in Africa is the comparative lack of disposable income, leaving consumers extremely sensitive to prices. Average income in sub-Saharan Africa was \$1,624 in 2013, according to estimates from World Bank. “If you’re trying to sell a product in sub-Saharan Africa you’re going to struggle,” Mr Becerra says. “It’s a low income and price driven market, so you’re just going to compete on price.”



## Breaking borders

From Canada to China, barriers overshadow growth for expanding SMEs

There are small islands of opportunity in Africa, nonetheless. Mauritius, about 2,000 kilometres from the southeast coast of Africa, is frequently cited as one of Africa's top investment destinations, due to the island nation's stable parliamentary system of governance and diverse English and French-speaking population. In 2013-2014, Mauritius ranked ahead of all other African countries in the World Economic Forum's global competitiveness index. Zenitex aspires to enter the Mauritian market "because of the ease of doing business there, local government support and because it is a tourism hub", says Mr Desai.

Despite Zenitex's optimism about Mauritius, Mr Desai believes that in most of Africa much larger companies have the upper hand, squeezing the smaller players out of the action. "Large-cap companies and investors have gobbled up most of the major public sector contracts in Africa over the years," adds Mr Desai. "They are poised to continue to be the major investors in Africa. A general impression of the African market thus makes SMEs feel that the bigger players will make it extremely difficult for them and other small investors to successfully bid on the larger contracts. Most foreign SMEs look on African countries as the territory of the larger firms."

## Case study: UK's BuffaloGrid—building a mission-driven business

Top 3 reasons for success:

- \* Business model is defined by a social mission to bring mobile chargers to rural communities
- \* Target growth markets are those geographies often ignored by larger companies and other SMEs
- \* Finds trustworthy partners and networks before entering new markets

BuffaloGrid—which deploys solar powered mobile phone chargers into Uganda, and is expanding into rural India and Southeast Asia—is essentially a developing country-focused SME with a unique advantage: based in the UK, it has G7-level management expertise, institutional muscle and financial machinery at its disposal, which serves to offset at least some of the risks of its business model. That the business is built on going where few have ventured before not only earns the company coveted press attention, but also helps them protect the proverbial 'first-mover' advantage—a golden egg for any business.

"In five years we aim to be all across sub-Saharan Africa and Southeast Asia, and the

Amazonian region is also very interesting for us," says Daniel Becerra, managing director of BuffaloGrid. "In five years we aim to be on at least three continents. We deploy these units for around 400 pounds sterling and they generate around 300 pounds of revenue every quarter. So the units pay for themselves over two quarters and become profitable for two to three years."

But no business model, no matter how noble or savvy, is without risks. For BuffaloGrid, the first major risk is identifying trustworthy partners to penetrate their targeted communities, and the second is being able to partner with local telecommunications network operators. "We are paid by text message, so we need the back end servers of the network operators to get engaged with us," Mr Becerra says. "We need system integration with their network. It's a very straightforward procedure, but very difficult to get them involved. We've actually been trying for over two years to get them involved in this payment integration [in India], but it's not until the Indian government approached us that they were able to pull the strings to get the network operators engaged."



# 4

## Investing in China—too big to fail?

While Africa as a whole struggles to win the confidence of SMEs from both developed and developing markets, China remains a magnet for SME confidence and investment—the world’s most populous nation and second largest economy is the most attractive developing market, according to survey respondents.

Compared to a complicated democracy like India, China’s government—despite its flaws—is perceived as an effective decision-maker in the realm of economic policy and infrastructure, given the country’s determination to be the epicentre of Asia, as well as its relatively streamlined, top-down political system. Competing political voices and interests have far less ability to roadblock or stifle orders from the top leadership in China.

There are some areas of concern, of course. The spectre of intrusive government, censorship, corruption and a politically charged regulatory environment always looms. Yet, after the final tally, it’s the size of China’s market, and the relative effectiveness of the government’s economic-growth-and-stability-at-all-costs development model that earns the favour of many SMEs.

“Yes, of course it is attractive,” says Mr Iwasa, regarding China’s status as the most attractive developing market for SMEs such as Cerevo. “The regulatory environment is a bit sensitive, but market size and vitality outweigh any negatives.”

For home-grown sportswear firm Hosa, the coupling of China’s massive population with the country’s accelerating urbanisation trend is the reason the company plans to allocate most of its resources to expanding at home—a reminder that China is much more than just the marquee cities of Guangzhou, Shanghai and Beijing on the country’s eastern seaboard.

“Although the growth of China has slowed down a little bit in the last two years, the main attraction is the huge population,” says Dickson Lai from Hosa. “Compared to Africa or Brazil, the urbanisation process is very quick with people moving from the countryside to the city. They will demand more and more due to purchasing power.”

While China’s infrastructure development may be impressive, China still has a long way to go to transform itself from a manufacturing and export-driven economy to one that is equally fuelled by disposable incomes and domestic consumption. Consumption as a percentage of GDP is roughly 35%, and investment about 45%, the most extreme divergence among the major economies, according to the Australian National University’s East Asia Forum. Some experts say China’s greatest challenge in this regard relates to the underdeveloped areas outside of its largest cities—poorer regions that have yet to feel the trickle-down effects of the country’s economic resurgence. (Figure 5)



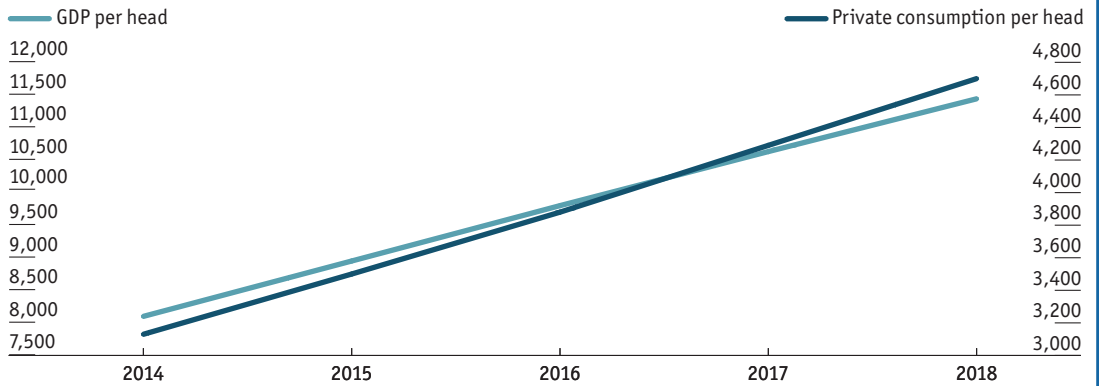


## Breaking borders

From Canada to China, barriers overshadow growth for expanding SMEs

**Figure 5: Growing consumption**

**Consumption in China is increasing faster than GDP**



Source: The Economist Intelligence Unit

“China is building some of the best road, rail and telecommunications infrastructure in the world, and its largest cities are more comparable with Western cities in terms of consumer sophistication and spending power,” says Mark Hedley, China business adviser at the China-Britain Business Council. “At the same time, some regions of China are less developed and average income levels are much lower. Furthermore, dependable nationwide distribution is increasingly mooted as potentially a significant barrier to China’s new focus on becoming a consumption-driven economy. SMEs should balance all these issues before deciding on how to step into this market.”

## Think local, stay global

Another China-specific question SMEs face is whether the country’s investment appeal justifies the cost of establishing a local presence and paying incorporation fees, or whether it’s more effective to avoid those potential headaches in favour of partnerships with resellers whenever possible.

“While some companies can easily sell into the market via distributors or agents and require minimal local presence, others will need to invest in setting up a physical presence in China and employing staff locally,” Mr Hedley continues.

“There are costs associated with setting up a wholly-owned entity or representative office in China, and setting up an entity takes longer and is a more bureaucratic process than in other markets. There may also be costs for exporters when going through approval or registration processes in China, costs for registering patents or trademarks locally in China also need to be considered. However these costs are not necessarily prohibitive when weighed against the potential scale of the opportunity.”

Canada’s Clevest is bullish on China given the development and modernisation trend of the country’s huge utilities industry, and CEO Thomas Ligocki frequently visits the country with Canada’s political leaders to seal deals for the software firm. For now, Clevest is reluctant to establish a permanent presence in China and prefers to work with distributors, although the situation on the ground can always change. In September 2013, the Chinese government established the Shanghai Free Trade Zone —the first such zone in mainland China. Clevest is currently evaluating the option of setting up an office inside the trade zone. Combining favourable start-up costs with good infrastructure and stable government, the barriers to overseas growth can quickly disappear.



## Case study: Canada's Clevest—partnering with government

### Top 3 reasons for success:

- \* Seeks government support to help close deals, rather than source new business
- \* Partners with government for high-level support in countries of shared interest
- \* Keeps government relations and business operations entirely separate

While a large number of survey respondents say governments can do more to support SME growth ambitions, Canada's Clevest believes the opposite: companies should manage expectations and look to governments not as business development agents, but simply as stamps of high-level approval. Business growth is the job and responsibility of the business—the role of governments is to clear political hurdles, if and when required.

"I may be the exception—but I don't share that view," says Clevest's CEO and chairman Thomas

Ligocki about the perceived lack of strong government support. Mr Ligocki spent 15 years in the mobile workforce management industry before founding Clevest, and earned mention as a 'top business influencer' in Vancouver's 'top 40 under 40' list.

"Whenever I ask for help, I receive the help," Mr Ligocki says. "I think it's a matter of understanding what you are asking for. One of the things that people sometimes ask is can the government help you generate new leads and opportunities. Personally I don't look for that because I'd probably be disappointed. I don't look to the government to do my job for me. I look to the government for ways to help us close business. And I look for the government to legitimise small business by using their muscle and political support. I'm not looking for them to lead introductions or be knowledgeable enough to explain why our solution is better than someone else's—that's my job."



## Breaking borders

From Canada to China, barriers overshadow growth for expanding SMEs

# Conclusion: Striking the balance

International expansion is increasingly necessary for 21st century SMEs. Transformational change stemming from advancements in technology and communication is creating opportunity like never before—SMEs can either grab such opportunities, or give them away to a competitor.

Many hurdles on the way to achieving meaningful growth remain. But despite the infrastructure challenges, political risks and other significant challenges associated with expanding abroad, SMEs in general remain confident that they are equipped to overcome key hurdles to successfully

grow their businesses in new markets. For most, this involves a careful evaluation of the balance of risks versus potential rewards in developing economies such as Africa, and of the balance of opportunity versus costs in the more established markets of North America and Western Europe. As many SMEs have found, risks, and costs, can be reduced by sealing effective partnerships, whether with well-established local vendors or local governments. Those SMEs who prove the most adept at forging alliances may be best-positioned to capitalise on the increasingly international nature of business going forward.

While every effort has been taken to verify the accuracy of this information, The Economist Intelligence Unit Ltd. cannot accept any responsibility or liability for reliance by any person on this report or any of the information, opinions or conclusions set out in this report.

LONDON

20 Cabot Square

London

E14 4QW

United Kingdom

Tel: (44.20) 7576 8000

Fax: (44.20) 7576 8500

E-mail: london@eiu.com

NEW YORK

750 Third Avenue

5th Floor

New York, NY 10017

United States

Tel: (1.212) 554 0600

Fax: (1.212) 586 1181/2

E-mail: newyork@eiu.com

HONG KONG

6001, Central Plaza

18 Harbour Road

Wanchai

Hong Kong

Tel: (852) 2585 3888

Fax: (852) 2802 7638

E-mail: hongkong@eiu.com

GENEVA

Rue de l'Athénée 32

1206 Geneva

Switzerland

Tel: (41) 22 566 2470

Fax: (41) 22 346 93 47

E-mail: geneva@eiu.com

SINGAPORE

No. 8 Cross Street,

#23-01 & 04 PWC Building,

048424,

Singapore

Tel: +65 6534 5177