ROLAND BERGER STRATEGY CONSULTANTS

think:act CONTENT

Fresh thinking for decision makers

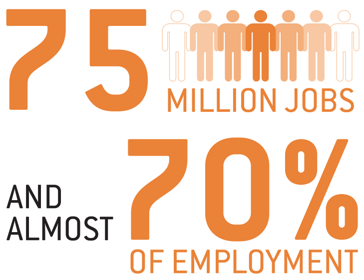
What role can banks play in the internationalization process of European SMEs?

It is easy to get the impression that the European economy is mainly dominated by large multinational enterprises

SEPTEMBER 2013

WHAT ROLE CAN BANKS PLAY IN THE INTERNATIONALIZATION PROCESS OF EUROPEAN SMEs ?

→ It is easy to get the impression that the European economy is mainly dominated by large, multinational enterprises. Their multi-billion Euro takeovers, global expansion plans or more recently risks of mega bankruptcies dominate the headlines. What usually gets lost is that more than 99% of all European enterprises are SMEs in fact, providing 75 million jobs and almost 70% of employment.



According to the European Commission definition, the main criteria determining whether a company is a SME or not, are the number of employees and turnover. Even if the definition varies from a country to another, the EC considers that businesses with less than 250 employees and less than EUR 50 million in turnover are SMEs.

SMEs account for 60 to 70 percent of job creation and for almost 60 percent of the total gross value added in the EU. They are the true back-bone of the European economy, being primarily responsible for wealth creation and economic growth, next to their key role in innovation and R&D.

In the globalised economy, global trade flows are forecasted to keep growing at a 6% CAGR until 2020 and consequently bring numerous opportunities. SMEs need to be able to confront an increasing competition from developed and emerging economies and to plug into the new market opportunities these countries are providing. SMEs' performance and competitiveness can be commonly measured by their level of internationalization. International activities reinforce growth, enhance competitiveness and support the long-term sustainability of companies. However European SMEs still depend largely on their domestic markets despite the opportunities brought by the enlarged EU Single Market and globalization at large.

INTERNATIONALIZATION OF SMEs HAS BECOME A MAJOR PRIORITY FOR ECONOMIC GROWTH IN EUROPE

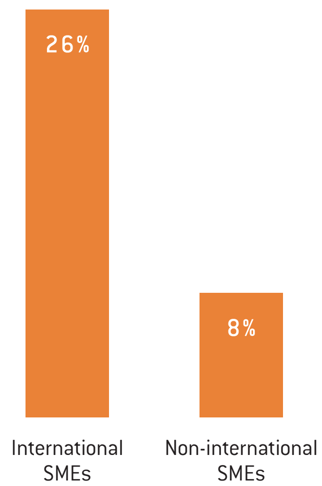
→ Studies conducted at EU level clearly suggest that international SMEs drive job creation and foster growth: internationally-active SMEs report an employment growth of 7% versus 1% for SMEs only active on domestic markets. Furthermore, international SMEs are more innovative: 26% of internationally-active SMEs introduced new products or services for their sector and in their country, whereas average for all SMEs is three times lower.

A study conducted over 10 000 SMEs by the European Commission in 2011 highlighted that SMEs are characterized by a relatively low level of internationalization in major European countries. At the EU level, more than 25% of SMEs are involved in exporting or importing, whereas less than 10% are active in the other modes of internationalization (technical cooperation, subcontracting, foreign direct invest.).

The internationalization of European SMEs remains mainly limited to the Single Market with a restricted exposure to non-EU markets only half of them being active outside the EU. In total, only 14% of European SMEs are involved in imports beyond the Single Market, 13% involved in exports, and 2% in subcontracting.

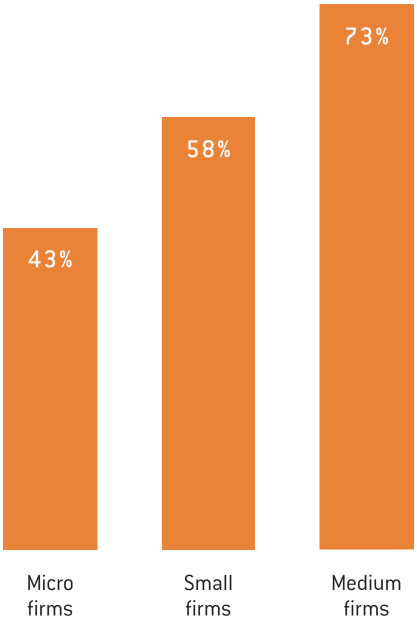
SMEs

26% of internationally active SMEs introduced products or services that were new for their sector in their country; for other SMEs this is only 8%



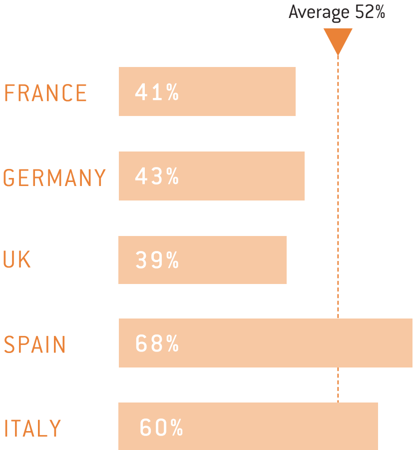
INTERNATIONAL ACTIVITIES

The percentage of SMEs that are involved in international activities is closely related to the size of the firm



INTERNATIONALIZATION

Of the five largest EU economies, lack of financing is claimed to be a major barrier to SMEs' internationalization



The share of exporting SMEs is not directly correlated to the national level of exports and economic prosperity. Thanks to a well-established export infrastructure or specialized international trading houses catering efficiently for foreign markets, numerous SMEs can thrive by producing for foreign markets and contribute to total value added without directly invoicing foreign customers. For instance, SMEs operating as subcontractors to large firms export their products internationally, and contribute to the European GDP and indirectly to the export performance of the country.

SMEs ARE FACING MANY BARRIERS IN THE PROCESS OF INTERNATIONALIZATION AND PARTICULARLY LACK OF FINANCING

→ SMEs suffer from several barriers to be fully internationalized. Common barriers range from lack of adequate information to public support, red tape, foreign regulation or cultural differences. These barriers are even stronger to overcome for smaller businesses without critical size, since the level of internationalization is closely related to the size of the company: 43% of micro companies in EU are internationalized, compared to 58% of small companies and 73% of medium companies.

Among all these barriers to SMEs' internationalization, lack of financing appears to be the toughest one. SMEs tend to suffer from a financial shortage impeding their expansion into foreign markets. For instance the total duration to get paid varies largely from one country to another. The EU average is 53 days, 32 days in Germany compared to 121 days in Italy. The different payment terms force SMEs to change their cash management habits and adapt their organization.

Therefore gaining insight into the financial barrier that SMEs may encounter enables to precisely target SMEs' specific financial needs and what role can banks play in this process.

BANKS ARE A CORNERSTONE TO THE INTERNATIONALIZATION OF SMEs

→ Banks offer a large range of financial services that SMEs deem key to facilitate trade and cover financial risks.

Trade Finance and solutions such as exports and imports documents, bank guarantees, or standby letters of credit aim at meeting SMEs' expectations in terms of reactivity or products expertise. Half of internationalized SMEs consider Trade Finance essential to enter new international markets. Risk Coverage, such as currency risk (forward exchange, currency options, etc.) and rate risk (swaps) is used by 75% of international SMEs for International Cash Management (e-banking, cash pooling, etc.).

In addition to Trade Finance and Risk Coverage, International Payments, International Financing and International non-bank Advisory provide a full range of services to alleviate internationalization barriers. As an evidence, accounts opening (accounts abroad, currency accounts) or payments (transfers, checks, etc.) are used by more than half of international SMEs. International Financing (currency loans, debt raising, credit prospecting) is expected by 50% of SMEs. International non-bank Advisory such as partnership developments, answers to the need of market knowledge and local support is only required by 25% of SMEs.

MAJOR EUROPEAN BANKS NEED TO IMPROVE THEIR OFFER AND ENHANCE THEIR EUROPEAN FOOTPRINT

→ Over recent years, European banks have been reducing their footprint across Europe. Many banking groups have been disposing of their international positions, be it in Retail Banking, Specialized Financial Services, and Corporate and Investment Banking to refocus on their core business and home country client base. These movements were triggered by the 2008-2009 crisis and its aftermaths: stronger regulation requiring more equity for a given activity, regulators expecting specific business shut downs in exchange for State support, etc.

Roland Berger realized an extensive review of the 20 largest European banks' international setup to understand how they could improve their support to SME clients in their international activities.

1 - Differentiate the offer with value-added solutions and appropriate marketing

Reviewing offers of the leading European banks, product differentiation remains very limited, be it in Trade Finance, Hedging Solutions, International Cash Management or payments. Product differentiation stems mainly from banks that offer non-bank Advisory through dedicated subsidiaries or local partnerships. This support is primarily valued by SMEs trying to set up overseas.

Three dimensions can be investigated to differentiate offer through value-added solutions. Firstly, setting up an interface across products such as Cash Management and Trade Finance would enable SMEs to benefit from an integrated offer. For instance, a leading German bank has developed a treasury platform that distributes both Market and GTB products. This platform ensures SMEs an access to strategic and tactical financing tools through a single window. Secondly, developing secured internet-based solutions such as Banking Payment Obligation solutions would offer higher value to clients. Thirdly, supporting the treasury monitoring through mobile devices would back up SMEs' managers. For instance, a leading CIB French bank is now providing its clients with software to follow progress on documentary credit through mobile phones or tablets.

Along with the development of value-added solutions, marketing should be used as a differentiation tool, with a clear use of brand name, positioning and level of service. A major French bank has designed a specific brand name for its international offers, another went as far as defining an umbrella brand name which encompasses all international solutions.

2 - Adapt the organizational model and regroup competencies

Through our study, Roland Berger highlights that organizational models vary from a geographic area to another, and depend on level of centralization and degree of specialization. Five generic models have been identified: the World Network, the Global Specialist, the Hybrid European, the Regional Industrialized and the Regional Coordinated. As an example, the World Network model relies on the coordination among retail networks in numerous countries as well as the competencies of two global business lines: International Cash Management and CIB.

3 DIMENSIONS CAN BE INVESTIGATED TO DIFFERENTIATE OFFER THROUGH VALUE-ADDED SOLUTIONS

CASH MANAGEMENT

SECURITY

SUPPORTING THE TREASURY MONITORING

WORLD NETWORK
Normalized international network supported by GTB business lines

HYBRID EUROPEAN
Domestic banks supported by a Corporate business lines

GLOBAL SPECIALIST
Specialized business lines integrated in the retail network

REGIONAL COORDINATED
Regional banks coordinated by a central entity

REGIONAL INDUSTRIALIZED
Regional banks supported by a shared services center

Models under analysis in our review point out two key success factors: adapting organizations to core competencies, and regrouping competencies in a single entity whatever the type (business lines, geographical entity, etc.). Furthermore it has been highlighted that, banks have hardly opened to external partnerships in every model.

Roland Berger recommends to shift the model to develop partnerships and keep only core competencies. Several other industries such as automotive or insurance have proactively sought to focus on areas of expertise in the value chain, choosing to produce or to delegate to specialized players. Conversely banks have not yet gone through the analysis of their target operating model, and prioritized core competencies to be developed. Roland Berger considers that the lack of a clear industrial setup results in a number of missed opportunities and inefficiencies.

3 - Create steering mechanisms, across businesses and hierarchical lines to assist international SMEs

Given that existing organizational models are usually structured around business lines or geographical areas, European banks' organizations are not adequate to the transversal dimension of internationalization process. When it comes to foster the internationalization of SMEs, both retail and specialized products are required across geographies.

To carefully support the internationalization of SMEs, European banks have to implement disruptive steering mechanisms. Steering should focus on two priorities: providing banks with monitoring tools, and defining clearly a steerer across geographical areas and business lines. Along with these two priorities, coordinating partnerships with third parties domestically and internationally remains a key success factor, especially when it comes to cash management for correspondent banks, banking partners abroad or providers of ancillary services such as local legal advice.

In our review, Roland Berger highlights that banks have been struggling recently to adopt an appropriate steering mechanism. Smaller banks seem to implement better steering mechanisms than larger banks, as their Trade Finance activity is usually in charge of monitoring international client service and penetration. Larger banks have tested various options, but no sustainable solution has been fully convenient at this stage: creation of a central steering body within the core country retail banks, dedication of teams within the CIB, allocation of the steering responsibility to a Global Transaction Banking business, etc.

4 - Choose the territory of communication

Successful banks should choose a territory of communication, coherent with the bank's culture and assets through four main dimensions: level of personal support, level of expertise, breadth of geographic coverage, ability to centralize international management. For instance, a large retail Dutch bank has expanded its geographic coverage thanks to multiple partnerships and abilities to support its clients in a close relationship.
An international universal bank has put forward the geographic coverage of its many local retail branches as well as its ability to provide experts in each type of transaction.

Roland Berger recommends to enhance territories of communication through three potential angles : product, country and client needs. Although most banks communicate on products and solutions they offer, and to a lesser extent on the countries they cover (with country synopsis), Roland Berger has identified some particular cases in which banks based their communication exclusively on client needs. As an example, a large French bank uses a didactic approach to meet client's need to appropriate solutions. A Dutch bank proposes case studies according to specific needs ("You want to launch your products outside of the Netherlands…", "You seek to invest outside of the Netherlands…").

EUROPEAN BANKS COULD STIMULATE EMPLOYMENT AND GENERATE UP TO 600,000 JOBS IN EUROPE OVER THE FIVE NEXT YEARS THROUGH FURTHER SUPPORTING TO SMEs' INTERNATIONALIZATION

→ Roland Berger estimates that up to 600,000 jobs could be created as the result of a full financial support to European SMEs' internationalization. Out of current 75m European jobs in SMEs, 4% of SMEs claim potential to grow internationally in the 5 next year. By providing financial tools to support international expansion, European banks would facilitate job creation growth in internationalized SMEs from 1% up to 7% per years, i.e up to 40,000 additional jobs in 2014 and 200,000 jobs in 2018.

CONCLUSION

→ Around one third of European SMEs are engaged in international activities, but only a limited share is involved in internationalization beyond the Single Market. Internationally-active SMEs report higher turnover and employment growth. Therefore the support to internationalization process is critical for European economies. The refocus of European banks on their core countries since the 2009 crisis has been raising the issue of financial support to international SMEs.

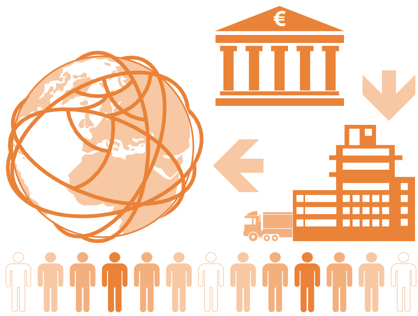
However few banks have so far fully reviewed their international setup in terms of offer differentiation, organizations, steering mechanisms, and communication, as they focus on reducing international presence and exposure. In addition fewer banks have started opening their model to banking and non banking partners, and developing innovative long-term profit sharing mechanisms.

The implementation of a new model to support SMEs internationally will require strong commitments from banks. But those who make these changes will be well-rewarded with growing business opportunities, while contributing to the recovery of the European economy and fuel long-term job creation growth.

Roland Berger estimates that up to

600,000 JOBS

could be created as the result of a full financial support to European SMEs' internationalization



SHOULD YOU HAVE ANY QUESTIONS, PLEASE DON'T HESITATE TO CONTACT US

Cécile André, Partner
+33 (6) 73 84 90 98
Cecile.Andre@rolandberger.com

Guillaume Chrun, Principal
+33 (6) 87 59 58 84
Guillaume.Chrun@rolandberger.com

François Drogoul, Consultant
+33 (6) 63 45 95 31
Francois.Drogoul@rolandberger.com

think:act CONTENT
Editors:
Prof. Dr. Burkhard Schwenker, Charles-Edouard Bouée
Overall responsibility: Prof. Dr. Torsten Oltmanns

Roland Berger Strategy Consultants GmbH
Am Sandtorkai 41
20457 Hamburg
+49 40 37631-4421
par.marketing @rolandberger.com
www.think-act.com