The rise of micro-multinationals

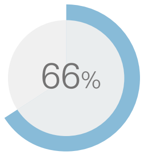
HSBC
Commercial Banking

A new breed of company – the micro-multinational – is challenging old ways of doing business. For decades, the biggest firms operated internationally, while smaller firms tended to be domestic. Today, nimble mid-sized firms are taking on new markets earlier in their business cycle. This audacious expansion is changing the face of global commerce; challenging bigger more established players and providing plenty of models for smaller firms to learn from.

This report, based on insight from a range of HSBC experts who look after mid-sized firms, examines the characteristics of a successful micro-multinational. It also considers the opportunities still to be realised, as well as some of the challenges that could hinder their growth.

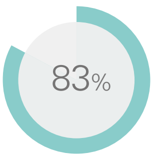
What makes a micro-multinational?

SMEs surveyed in 2013 predicted **66%** of their revenues would be generated from **outside their home market** this year. Over **half** said innovation and **growth** would come from **online** networks and platforms[1]



Bigger than a start-up, but not yet the scale of a sprawling corporate, mid-sized companies are increasingly taking advantage of growth outside their own market and going international. ***"These companies are not just buying and selling internationally, their operations are in multiple markets,"*** observes Vivek Ramachandran, HSBC's Global Head of Product & Proposition for the trade business.

In the UK, 40% of micro-multinationals have opened offices in new markets in the last five years – one of the highest rates in the world, according to a study by FedEx Express. This trend is set to continue with 83% of small to mid-sized businesses citing overseas expansion as their top priority, according to the Radius Global CFO Survey.



83% of small to mid-sized businesses cited overseas expansion as their top priority, according to the Radius Global CFO Survey

In the past it was difficult for smaller companies to expand as they needed to understand local regulations and market dynamics, as well as identify new partners - information which was not readily available.

Over the last couple of decades, technology has made information and connections more democratic, with companies being able to research online and network across borders more easily. ***"If opportunities in a home market are hard to come by - for instance, in many Western markets growth has been 0-1% for a few years - then going international offers mid-sized companies a real chance to grow faster on an international base,"*** explains Regis Barriac Head of International, HSBC France.

Micro-multinational firms often mirror the mind-set of the 'global citizen' - in that their identity transcends one country or even an entire product.

Traditional business models tend to manufacture end-to-end goods, from raw material to finished article - or a wide range of goods and services in a particular sector. However, today's micro-multinationals are breaking this mould. Instead, they see themselves as niche global players, specialising in one part of a production cycle or providing highly specialist goods or services. For instance, one component part of a mobile phone, or one process in a financial transaction.

1 According to a 2013 study of 2,100 SMEs across 21countries conducted by Oxford Economics and SAP, "the roster of SMEs generating more than 40% of revenue outside their home country will have increased by 66%" by 2016. And more than half of respondents said they would drive global innovation and growth by participating in online business networks and platforms.

Gary Hufbauer of the Peterson Institute of International Economics explains: ***"In earlier waves of globalisation it was all about countries and their comparative advantage … but now we are entering an age of global firms battling other global firms in increasingly narrow specialisms to gain their share of lucrative markets."***

The onset of the digital age has also allowed small and medium sized companies to level the playing field against their larger competitors. Digital and online solutions have cut costs and barriers to entry, especially in emerging markets.

"Digital platforms are overcoming many costs which previously held SMEs back from trading small goods internationally," comments Dr Joshua Meltzer, Senior Fellow, Global Economy and Development, Brookings Institution. ***"Even cross-border costs are being reduced."***

Technology is also an important component in creating efficiencies. Younger firms unburdened by legacy systems have been able to use these new tools to serve new markets. If you are more efficient than your peers, then you have a competitive advantage, something micro-multinationals understand all too well.

These firms are also likely to benefit from the rise in social media. Vloggers and bloggers influence millions of people, and in many cases, their views are followed internationally. This new force in citizen journalism is helping smaller brands, once confined to domestic markets, become globally coveted which, in turn, helps their expansion. Receiving third-party endorsement and recognition can help to create an international customer base and remove some of the hurdles of entering a new market, such as building brand awareness.

"Social media can mean that once a brand is established in one market it can quickly and easily be communicated around the world - this is something micro-multinationals are really taking advantage of - and in the UK it has been seen within fashion, luxury and food brands," says Amanda Murphy, UK Head of Corporate Banking, HSBC .

Enjoy Education

CASE STUDY

Enjoy Education (EE), a UK-based company which offers tutoring and schools advisory services, , successfully uses online platforms to deliver high calibre education across the world. With a presence in China, Russia and the Middle East, it has seen a rapid increase in demand from international families. This has translated into an impressive 30% year on year growth in the last three years.

Founder and CEO, Kate Shand, took the opportunity of joining the UK's Prime Minister, David Cameron on a trade trip in China to launch EE's new tutoring platform in 2013. Smart use of new platforms and an understanding of how to build an online brand has helped EE to widen its market and become a thriving micro-multinational.

5 traits of a micro-multinational

Global mindset

they think across borders and have the confidence to innovate

Intermediate

typically they're a mid-sized company

Agile

expanding internationally early in their business lifecycle

Niche

offering new ideas or just one element of a good or service

Tech Savvy

using new technology to foster their network and brand

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A global phenomenon

across
15 economies
there are
161,800 MMEs
with a combined turnover of
$16.6 trillion

The rise of the micro-multinational is not limited to a specific country or region. These mid-sized firms also have a significant and often under-appreciated impact on the global economy.

An HSBC study found that mid-sized firms play a key role in the economic prosperity of nations. The report, *Hidden Impact – The Vital Role of Mid-Market Enterprises* found that across 15 economies, there are 161,800 MMEs with a combined turnover of $16.6 trillion.

Think tank, The Lisbon Council, estimates that all net job growth in the US between 1980 and 2005 came from firms less than five years old. Every year between 1997 and 2008, more than 2.5 million people in the US created their own job by becoming entrepreneurs. The companies they formed also created more than one million additional paid jobs each year.

Globalisation has made it both easier and more attractive for smaller firms to operate internationally, rather than just domestically – whether that means establishing physical operations in overseas markets, sourcing goods from suppliers around the world or selling into foreign markets.

"Really forward minded businesses are benefitting from an interconnected world," explains Amanda Murphy, UK Head of Corporate Banking, HSBC. ***"However, they can suffer from the middle child syndrome - not as influential as the big brands so not able to break into government export financing, but not small enough to receive political attention and the support which tends to go with this. This means they are often far more resilient and self-reliant."***

In the UK, MMEs account for around 3.4 million jobs and nearly 14.6% of the national total. For many of these companies, international growth is a significant focus. ***"For a lot of the companies that we're dealing with, the fact they are trading internationally means they grow significantly faster than those that are purely domestic,"*** adds Murphy.

A recent HSBC report found that mid-sized companies in the countries surveyed contributed between 20-40% of GDP and employment in their local economies.

"Exporting should not be considered solely the domain of long-established or large players. A significant percentage of exporters are small and medium size businesses."

John Longworth, Director General of the British Chamber of Commerce, 2015 Annual Trade Survey.

Mid-market enterprisess from all industries are exploring global opportunities. ***"British brands are often seen as a hallmark of quality overseas,"*** says Murphy. ***"I noticed on a recent trade trip to China that there is a huge acceptance and appetite for brand Britain. UK companies are taking advantage of this reputation for quality as they expand in new markets. In some sectors, such as the healthy food sector, they are also focusing on building international franchises."***

The International Franchise Association expects that 2016 will be the sixth consecutive year in which franchise businesses grow at a faster rate than non-franchised businesses

In Asia, China has been pivotal to the sourcing of goods in the past few decades, thanks to its competitive cost base and infrastructure. However, as China moves up the value chain, companies are increasingly diversifying their sourcing and production bases to South East Asia, such as Indonesia, Vietnam, Cambodia and the Philippines. When it comes to sales, Asian micro-multinationals are also looking to diversify their buyer base. Instead of looking to the US or Europe, where economic growth continues to be slower, firms are increasingly shifting their focus to other higher growth areas, especially China and intra-Asia markets.

"There is a trend for firms to expand internationally, with Hong Kong acting as a treasury hub," explains Christina Ong, HSBC's Managing Director of Commercial Banking in Hong Kong. ***"Companies want help to improve margins, move up the value chains and seek professional advice about expanding into the overseas markets. Those successful cases of companies operating internationally – expanding into China, Bangladesh, Vietnam, Cambodia - are the ones that started early and with scale."***

In many cases, the size of the local market will play a significant part in determining a company's appetite for overseas expansion. In the Middle East, for example, some markets are relatively small. ***"There's a growing trend of middle market companies spreading their wings and exploring new markets in this part of the world,"*** explains Ahmed Abdelaal, Regional Head of Corporate Clients Coverage MENA and Head of Commercial Banking UAE. ***"Once middle market companies reach maturity in their home market, expanding overseas allows them to explore other opportunities. By piloting in smaller markets they are able to scale up very quickly in bigger markets such as Saudi Arabia and Egypt."***

Industry sector can play a part in determining how quickly they are likely to look beyond their domestic market. ***"In India, software and IT services companies tend to include a lot of international companies as they have a different mind-set about expanding internationally earlier in their business lifecycle,"*** says Rajat Verma, Head of Corporate Banking, India.

Planning expansion

Micro-multinationals tend to have a very clear strategy for each market they are targeting.

While it can be tempting to spread the net wide, successful mid-sized companies make the most of their key strength: agility. They don't want to add complexity to their organisation. Instead, they spend time doing the necessary due diligence on new marketplaces and understanding local regulations and business practices. Each step is a disciplined process.

Unlike traditional multinational corporations, micro-multinationals typically have fewer levels of decision makers, so can take advantage of new opportunities quicker than their larger counterparts. This means they are nimbler, able to innovate swiftly to keep up with market trends and customer requirements, and willing to challenge the status quo. However, in terms of entering new markets, middle market firms may also be viewed as less of a threat than larger companies by existing players in the market who are more focused on their larger competitors.

"The best micro-multinationals leverage their own characteristics to their full advantage," says Ahmed Abdelaal. ***"Large corporates are systematic in their expansion strategy, it's hard-wired. For a micro player, they are not so systematic but instead fit their opportunity to size and capacity."***

The opportunity to set up a simplified global model – or multi country model – is a hallmark of micro-multinationals. Rather than aping larger players, these smaller disruptors are likely to hub operations out of their home market, keeping oversight of their operations.

Paessler

CASE STUDY

Paessler is an IT monitoring specialist based in Germany. Its 'PRTG' product is used by over 150,000 IT administrators in more than 170 countries. Founded in 1997, the company employs around 150 staff. Paessler operates its business internationally through its website and a growing network of IT channel partners in their priority markets. Although the vast majority of its staff are based at the company's HQ in Nuremburg, this approach allows it to effectively service its customers all over the world.

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An important element to this model is making sure they have the right advisors and partners working in each market.

According to Vivek Ramachandran: ***"Technology enables you to manage a hub model, but you have to rely on individual relationships as the basis of moving into new markets."***

One big decision is whether mid-sized firms should enter a new market as a standalone business or as a joint venture with a local partner.

For some companies acquisition makes sense, especially when adventurous companies are growing quickly. The most successful inorganic expansions are when the decision is tightly aligned to a company's existing strategy and plans are put in place early to integrate processes.

"Rather than M&A, many companies in the Middle East are focusing on organic expansion," comments Ahmed Abdelaal. ***"For example, if they have a trading line out of UAE or Saudi, they would explore opportunities to take the same line of business and tap into a new geography, often by setting up a joint venture with a local player."***

Management structure

When companies expand by acquisition, it is important to make sure that the right management structure is in place. For example, Rajat Verma, says that Indian companies are increasingly seeking to retain existing management structures when they buy companies overseas, rather than imposing their own management in markets they don't fully know and understand.

In order to navigate new markets successfully and build a strong team, companies need people with experience of operating internationally. In some cases this means looking to recruit employees with experience of working within larger multinationals. In the US or UK, finding people who fit this profile of having worked in multinational firms and an ability to speak English, the international language of trade, is perceived to be easier than other markets.

These relationships also have a cultural aspect. Amanda Murphy has worked with micro-multinationals in a number of markets and explains: "***I've spent a lot of my career in Asia and the Middle East, in those cultures business relationships take a long time to build. Our successful customers understand this and make time to visit again and again to nurture relationships."***

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Key concerns for micro-multinationals

Establishing new partnerships – understand the cultural context

Finding employees with international experience – look to larger multinational companies when recruiting

Staff retention – listen, have a purpose, involve your employees in your vision and let them contribute to your strategy

Smarter ways of financing – talk to your bank, find out what global best practice looks like

Working capital – forensically examine your days outstanding and other data

Cash flow and the visibility over their cash flows – consider a treasury management system earlier rather than later

Foreign currency management – invest in integrated systems which give you oversight

Supply chain efficiency – ask your buyers and sellers how you can work as partners in financing

Managing the finances of a micro-multinational

almost
75%
of companies with a turnover of less than
£250m

don't have a
Treasury management system

Treasury management systems

When it comes to managing company finances, having the right technology in place can be a challenge for micro-multinationals. Treasury management systems (TMS), for example, can be prohibitively expensive. ***"If you don't have TMS in one market, you can get it. But if you don't have it across a number of markets, then suddenly you can be handling exposure in multiple currencies and inefficient working capital,"*** says Vivek Ramachandran.

It's not just the systems, but also finding the right employees to manage the systems. In a new country, you might have only set up a branch or a subsidiary, with a small number of people who might not have the necessary skill-set.

Working capital management

Mid-market companies tend to be less efficient than large corporates when it comes to managing their case effectively, or reducing their 'cash conversion cycle'.

"The single largest challenge with micro-multinationals expanding is how to optimise working capital across multiple jurisdictions. If you have 'trapped capital' and you are funding your local operations with local capital, your working capital requirements are going to be much higher," Vivek Ramachandran points out.

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Vivek Ramachandra, Global Head of Product and Proposition for HSBC's trade business

As a business becomes successful, this can cause new headaches. The more successful you become, the more supplies you need. In some cases, suppliers can end up being paid faster than the payments are coming in. Perversely, additional orders put significant financial pressure on the business, as this only adds to the difficulty in managing working capital well. Companies may be able to reduce these pressures by addressing this area more proactively.

There are also matters of scale. A large multinational can be buying and selling in volume in one market, which creates liquidity – or the ability to balance payments going and out.

"Micro-multinationals need to think about how to tackle this in a way that doesn't add a huge amount of complexity. This is where technology can enable you by delivering a Treasury Management System and Treasury Management processes for payables and receivables. Managing liquidity across border is going to be key," adds Vivek Ramachandran.

Taking finance further

Micro-multinationals will often need to have different conversations with their banks as they need to use finance as a competitive tool in their businesses.

For example, a fast-growth company wants an in-depth conversation on all aspects of 'smart financing', from working capital management to increased cash flows and visibility over these flows.

Along with supply chain and procurement strategies, this can include factors such as building production near ports in order to help provide the next step in their supply logistics.

As a result, banking arrangements can present a number of challenges as a company expands.

For one thing, micro-multinationals can find it difficult to access the tailored banking solutions and support they need. While a local bank may have been a good fit in the past, that bank may be ill-equipped to support the company in overseas markets. At the same time, micro-multinationals may find they lack the scale needed to engage with domestic banks in their new markets.

For companies expanding by acquisition, another consideration is that banking relationships may need to be consolidated as the company grows. If legacy arrangements are kept in place, the company may end up with a number of different banks and platforms in different markets, which can lead to additional costs and inefficiencies.

"Micro-multinationals must be prepared to make a strong business case" Regis Barriac advises. ***"This needs to show they have strong projected growth and their sales will be stronger thanks to expansion. Then the conversation can start."***

Accessing the right support

Micro-multinationals can tap many different sources of advice – and the earlier they access this advice, the more effectively they can overcome their challenges. Typically, companies expanding overseas will rely on an audit firm or consultant to help them through the process of incorporating overseas. Local chambers of commerce and organisations such as UK Trade & Investment (UKTI) can also help companies gain a deeper understanding of new markets.

"The UKTI works closely with companies which are looking to enter and to export British goods into new countries," says Amanda Murphy. ***"This can be an invaluable source of information and support, as well as running trade missions to overseas countries."***

Diego Spannaus, HSBC's Head Of International Subsidary Banking Mexico, says: ***"In Mexico there are numerous trade associations and chambers of commerce that provide market studies, insight and support. ProMexico is useful for foreign investors."***

A joint research report by TMF Group and the Economist Intelligence Group found that in 2015 a third of US businesses turn to external service providers to complement their own knowledge and expertise when expanding internationally. A quarter might seek external help in just one area, such as legal, accounting or tax compliance.

Banks can also support micro-multinationals – not only by drawing upon their experience of specific markets, but also by introducing micro-multinationals to other companies which may have overcome similar challenges.

"One of my favourite things is connecting customers,' says Amanda Murphy. ***"I say to a***

customer looking at a market, let me introduce you to another customer of mine from another sector and you can hear from them the pitfalls, what they learnt and how they did their deal."

Banks can also help advise on what solutions are being used by the most forward thinking companies, as Rajat Verma explains: ***"In Europe you would typically have cash pooling. This is where balances in a number of bank accounts are aggregated to get a better rate of interest or to improve liquidity. Today, fast growing Indian mid-sized companies are asking for platforms to help them integrate their overseas operations. Often management resources are tied up in growth strategies and sometimes a good banking strategy can end up as a 'nice to have', rather than a 'need to have'. The most competitive firms know this and lean on their banking partners to understand what best in class looks like, not just financing but right up the supply chain."***

Furthermore, by building connections with peers and teaming up with other companies, micro-multinationals can make their voices heard more effectively.

Looking ahead

Changing trade patterns and new technology played a formative role in the creation of the micro-multinational. Looking ahead we see new trade winds blowing, such as the rise of trade in services, which will continue to shape commerce.

Fuelled partly by relatively robust consumer spending, services exports have expanded significantly in countries such as Australia, Germany, Japan, Sweden and the United States. Since 2000, economies like Hong Kong and Singapore have seen services exports increase relative to GDP by more than 15%. The most rapid growth was in areas such as travel and tourism and other services.

"In the future there will be a clear opportunity for smaller companies to join global networks. Businesses will be part of a global connection of agile, specialist micro-multinationals working together to produce goods and share services."

Stuart Tait, Global Head of Trade and Receivables Finance, HSBC.

Final thoughts for aspiring micro-multinationals

Don't be daunted
– the world is smaller than you think, especially if there is demand for your product

Think through your model
– use technology and professional systems such as treasury management early on

Make sure you use your partners
– your buyers and sellers and other advisers

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The World Bank Group's 'Doing Business 2016' report found that developing countries are making big strides in improving the business climate. Over 70% of regulatory reforms recorded in the past year were carried out by developing countries. Furthermore, it discovered that starting a business is becoming easier around the world: in 2003 it took an average of 51 days and in 2015 that average had more than halved to 20 days. Meaning many companies worldwide are reaching the point when they can consider expansion much quicker.

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