

IMMIGRANTS AND THE INTERNATIONALIZATION OF BUSINESS

– DO THEY INCREASE SERVICE EXPORTS?



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Immigrants and the internationalization of businesses

- do they increase service exports?

Andreas Hatzigeorgiou & Magnus Lodefalk

Introduction

Foreign trade is central to economic growth and jobs. The ability to purchase goods and services from abroad yields greater choice and lower prices. Internationalized firms are generally more productive and employ more workers than do other companies. However, most companies do not export or import. The barriers to internationalization and trade in a globalized high-tech economy are no longer tariffs and quotas but rather informal barriers. Thus, foreign-born employees can encourage internationalization by, for example, serving as knowledge carriers, trust enhancers and trade ambassadors.

The report Immigrants and the internationalization of businesses - do they increase service exports? analyses how migration can promote internationalization for companies and countries. With the aid of detailed registry data on Swedish companies, the report provides new insights into the role that foreign-born individuals can play in the internationalization of trade in services. Thus, it contributes to the understanding of the forces driving internationalization in general and, specifically, the potential implications that migration might have for a country's position in the global economy. The authors present three main conclusions and offer recommendations

ranging from external trade policy and migration to the internationalization promotion of businesses.¹

The growing importance of services is not clearly reflected in foreign trade

The world economy is increasingly classified as a service economy due to increasing importance of services in many countries. Disaggregating the United States economy by sector reveals that nearly to 80 percent of GDP derives from services. The corresponding figure for the EU is approximately 70 percent. In the last two decades, the average share of services in the total employment of developed countries increased by 12 percent. In contrast, the shares of primary and secondary industries declined by more than two-thirds over the same period. In 1991, manufacturing and services accounted for 25 and 75 percent of total employment in developed economies, compared with 16 and 84 percent in 2009. However, the growth of the service economy is not evident in international trade. Manufacturing trade continues to dominate international commercial exchange.

Informal obstacles represent greater trade barriers than tariffs

The greatest barriers to internationalization and trade in the contemporary globalized high-tech economy are no longer tariffs and quotas but informal obstacles. Research confirms the contention that a lack of knowledge of foreign markets and the absence of the necessary contacts precludes internationalization. These barriers are particular obstacles for small and medium enterprises.

New conditions for internationalization entail new demands from global competition in the form of sound information, trust between buyers and sellers, and reliable supply chains. According to small and medium-sized enterprises, four of the five highest-rated barriers to internationalization pertain to the lack of knowledge of and contacts in foreign markets. Thus, it is clear that foreign-born individuals' importance to internationalization has increased markedly in recent decades. This in turn alters businesses' ability to compete effectively in the global marketplace and affects what types of obstacles policy must assist enterprises in overcoming. Immigrants have the potential to contribute in several ways, which will be presented below.

1. This is a policy summary of the full report, which was written in Swedish.

TABLE 1. Ranking of the barriers to internationalization according to small and medium-sized enterprises

Ranking	Description of obstacles
1	Lack of financing for export activities
2	Difficulty in identifying business opportunities abroad
3	Limited information on how to analyse/locate marketsra marknader
4	Inability to reach potential customers in foreign markets
5	Difficulty in locating reliable representatives abroad
6	The lack of strategic planning for internationalizationg
7	Insufficient staff to address internationalization opportunities
8	Difficulties in matching competitors' pricing
9	Lack of government support in the home country
10	High transport costs

Source: OECD (2009), Hatzigeorgiou and Lodefalk (2011).

Migrants as knowledge carriers

Foreign-born individuals with knowledge of their countries of birth, such as knowledge regarding the country's inhabitants and their preferences, price sensitivity and willingness to follow trends, can be a resource for companies in the internationalization process (Gould, 1994; Rauch, 1999). The reason is that flawed, distorted or even false information may complicate internationalization efforts and increase the costs of international business. Acquiring knowledge about foreign markets is a central aspect of the internationalization process. However, knowledge of a foreign market is often country specific, and information about one market cannot always be used to enter other new markets. Immigrants can help to reduce – or even eliminate – uncertainties using their knowledge of the culture, history, politics and social norms of their former homelands (Dunlevy and Hutchinson, 1999; Jansen and Piermartini, 2009).

Migrants as trust enhancers

Through their contacts and social capital, foreign-born individuals can promote confidence and reduce the uncertainty that often is associated with internationalization

(Greif, 1989; Rauch, 2001). Initially, a business relationship concerns creating trust between potential partners abroad and a company in Sweden. Trust can be crucial for completing a deal and can reduce various costs involved in the transaction.

Migrants as trade ambassadors

It is reasonable to assume a positive correlation to exist between how well known a country is in different parts of the world and the ability of businesses in that country to export. Research indicates that countries' public promotion abroad, such as foreign representatives, may assist companies in their efforts to export to new markets (Rose, 2007). In addition to the effect on trade, such efforts appear to promote tourism. A clearer and more positive image abroad should improve the environment such that businesses are able to succeed in establishing positions and sales in foreign markets; however, it is clear that the basis for success abroad is competitive companies. Foreign-born individuals have the potential to improve public awareness of Sweden in their countries of origin. In so doing they may complement Sweden's public promotion efforts and its overseas business.

Migrants as mediators of ideas

Migration to and from Sweden has historically been important for the country's economy. Immigrants have contributed to laying the foundations for industry and production. Several successful companies were developed from new ideas that immigrants brought from abroad. Swedish-born returning immigrants have had a similar effect on growth and exports. Many of the individuals who emigrated from Sweden in the 1800s settled in the United States but returned home after a few years abroad. By contributing to the development of Swedish industry, migrants could indirectly assist the export industry. Therefore, foreign-born individuals, as carriers and spreaders of ideas across national borders, could promote existing businesses and contribute to the creation of new companies, which in turn creates opportunities for growth and further internationalization.

Migrants as exponents of new preferences

Foreign-born individuals promote internationalization through increased demand for specific goods from their countries of birth (White, 2007). This can lead to increased imports and create a ripple effect by changing the preferences of the general population. There are two primary reasons that one must consider this channel's potential effect on exports. First, imports

emanating from immigrants demanding goods from their countries of origin increase the familiarity of importer firms with foreign trade. This, in turn, can lead to exports, as the major step in internationalization is often identifying a partner abroad. To change direction in a particular business, from importing to exporting, is likely less demanding. Second, imports increase awareness of the preferences of consumers in foreign markets. Companies that import goods to satisfy a demand among a group of foreign-born consumers can customize their business based on this demand.

A new dimension of the trade-migration nexus: migrants' role in the internationalization of services

At present, trade in goods constitutes 70 percent of Sweden's total exports. Moreover, trade in services has grown significantly in the past fifteen years. Simultaneously, Sweden has also gained market share in the global services market. As mentioned above, a service transaction often requires a personal relationship. Obstacles in the form of information and trust are particularly important in the services trade. The customer never possesses complete knowledge of a service before its actual implementation. Similarly, the service provider cannot entirely guarantee that the service will meet the customer's expectations in advance; a degree of confidence is necessary for a deal to be reached. A lack of trade experience entails even greater uncertainty and higher costs in trading in a foreign market. Therefore, it is conceivable that foreign-born individuals – who are assumed to decrease transaction costs, reduce uncertainty and increase demand – have particular potential to promote trade for companies with less experience in international business.

International trade and migration in theory and empirical research

There are several models designed to understand and explain why, how and in what ways companies internationalize. The theoretical developments in both economics and business analysis emphasize the increasing importance of networking and contacts. It is important to empirically evaluate the link between migration and internationalization. A first step is to illustrate how international trade has evolved over recent decades in parallel with migration. It is estimated that approximately 200 million individuals worldwide reside outside their countries of birth. Migration and international trade have increased in tandem. Worldwide, the number of migrants nearly tripled between 1970 and 2010. During the same period, global exports grew by nearly tenfold.

TABLE 2. International trade and migration, 1970-2010 p 19

Year	Export (Million USD)	Import (Billion USD)	Migrants (Million)
2010	13 272	12 780	213
2005	10 613	10 584	195
2000	7 993	7 993	178
1995	5 480	5 369	166
1990	4 053	4 127	155
1985	3 034	2 986	105
1980	2 481	2 570	94
1975	1 817	1 948	83
1970	1 378	1 521	78

Note: Trade values are based on both goods and services calculated in constant year 2000 USD.

Source: World Bank (2013).

Empirical research suggests that there is a generally positive and statistically significant relationship between migration and increased foreign trade in goods. Certain studies also indicate a link between migration and investment. Regarding the foreign trade in goods, the evidence obtained at the levels of country groups and individual countries extends to the disaggregated level of regions within countries, as well as at the industry level. In summary, there are convincing reasons to expect that foreign-born individuals play an important role in increased internationalization.

Foreign-born individuals and service exports – analytical approach

Based on a theoretical model, the authors determine how investments in foreign networks affect firms' foreign trade. Based on an export revenue function, as well as information on relevant factors at the corporate and country levels, the authors construct an equation to estimate a company's export income. The empirical approach is applied to micro data from five databases of Statistics Sweden. The compiled statistics include Swedish manufacturing and service companies with at least ten employees for the period 1998-2007. Macro data are primarily obtained from the World Bank and CEPII. If an employee is foreign born, the data include information on how long the person has been a resident in Sweden and the person's level of education.

A positive correlation between the number of foreign-born workers and service exports

Based on the above approach, the authors estimate the correlation between the number of foreign-born workers in Swedish companies and these companies' services exports. After adjusting for firm-specific factors (such as total employment and productivity) and significant macro factors (such as GDP and population size), the analysis reveals that, on average, employing an additional foreign-born person is associated with a 2.5 percent increase in service exports to the employee's country of origin. Furthermore, employing an additional foreign-born worker increases the likelihood that a company will export services to the country in question.

Education strengthens the link between foreign-born employees and service exports – but this relationship weakens the longer that the foreign-born employee resides in Sweden

To analyse how the duration of a migrant's residence in Sweden and his or her level of education affects companies' services exports, the data are categorized into different groups. Three of the groups capture the time dimension: persons who have immigrated recently (within the last three years); those who have resided in Sweden for a moderate period (four to ten years); and those who immigrated long ago (resided in Sweden for more than ten years).

Foreign-born individuals are also divided into two groups based on their level of education. One group consists of foreign-born persons possessing only basic education (up to the secondary level), and the other comprises foreign-born individuals with tertiary education.

The results of this analysis suggest that employing foreign-born individuals with higher levels of education is positively associated with companies' service exports while those with less education are not. The strongest relationship with service exports to the foreign-born individuals' countries of origin is observed for foreign-born individuals with tertiary education who have resided in Sweden for a short time (fewer than four years). The relationship with export of services for this group is approximately seven times stronger than the general relationship; hiring an additional foreign-born person with tertiary education who has lived in Sweden for a short time is associated with 18 percent higher service exports.

The importance of networks and contacts illustrated by the estimated relationship between high-skilled foreign-born individuals and service exports is lower for individuals who have lived in Sweden for more than three years. For those with

tertiary education, the relationship persists after three years and does not differ significantly between the foreign-born who lived in Sweden for 4-10 and those who lived in the country for more than ten years.

Export experience affects service exports

Previous experience in international business is important in determining the extent to which companies interact with overseas markets. A lack of export experience entails greater uncertainty and higher costs when interacting with a foreign market, it is therefore conceivable that foreign-born employees – who are assumed to decrease transaction costs, reduce uncertainty and increase demand – have a special opportunity to promote trade for companies with less experience in international business.

To test this hypothesis, companies are divided into different groups based on their export experience. As expected, the results of the analysis reveals improved outcomes for companies with less export experience. The relationship between hiring an additional foreign-born individual and service exports is more than twice as strong for companies lacking experience exporting to foreign-born individual's country of origin – relative to the general estimation – and approximately five times as strong for companies with no previous experience in service exports.

More complex services entail greater potential for foreign-born individuals in promoting exports

Previous research that have attempted to determine whether information and contacts are the channels through which migration affects internationalization have generally analysed how the presence of foreign-born individuals affects trade in various products. Trade in so-called differentiated goods – often highly processed unique products – tends to be particularly sensitive to a lack of information and trust between buyers and sellers. The opposite are so-called homogeneous goods, which are increasingly regarded as interchangeable.

This hypothesis is examined by categorizing services based on their complexity. The results suggest that exports of complex services are particularly dependent on information and confidence, which in this case indicates that foreign-born employees could play a particularly important role in promoting a company's exports of such services. The authors find that the relationship between foreign-born

employees and Swedish companies' service exports is approximately 50 per cent stronger in advanced services relative to simpler services.

The report offers three main conclusions

1. Companies that hire foreign-born individuals export more goods and services than do other companies. For Swedish companies, employing an additional foreign-born person is associated with a two percent average increase in services traded to the foreign-born individual's home country. The probability that a Swedish company exports services to a country is also positively associated with the number of foreign-born employees who were born in that country.

2. Foreign-born individuals' capacity to facilitate trade can be increased through training and by maintaining networks and contacts in their countries of origin. Foreign-born individuals with a higher education exhibit a strong positive relationship with increased exports of goods and services for the companies that employ them. Hiring a foreign-born person with higher education who has lived in Sweden for fewer than four years is associated with an average increase in service exports to his or her country of origin of 18 percent.

3. Swedish companies with less export experience have the most to gain from hiring foreign-born individuals, particularly with respect to more complex services. By employing an additional individual originating from a particular foreign country, Swedish companies are twice as likely to begin to export services there. The relationship between foreign-born employees and exports is significantly stronger for complex goods and services than for simpler ones.

Directions for policy

From a policy perspective, this study highlights the paradox that while the movement of persons is both a means and mode of delivery for firms involved in service exports, such movement is the most restricted form of globalization (Freeman, 2006). Countries have eliminated numerous barriers to the movement of persons. However, the substantial discrepancy across countries with respect to their openness to persons who are willing to migrate – temporarily or permanently – with the aim of delivering services suggests that there is significant room for improvement in this regard.

Several studies indicate that the welfare gains from a limited increase in the movement of persons could be substantial (e.g., Walmsley et al, 2011). Moreover, as foreign-born individuals are often poorly integrated into the labour markets of their host countries, current immigrants represent an untapped source of potential for the promotion of service exports. Thus, our study emphasizes the need for policy-makers to improve labour market participation among the foreign-born population to promote internationalization, especially in service exports.

Recommendation 1: Incorporate migration issues into the trade policy framework

Information and confidence are likely to become increasingly important for Swedish companies' internationalization, not the least as a result of technological development, the emergence of fragmented production chains and an extended market for services and increased and changing global competition. Former prescriptions for increased internationalization and growth - primarily negotiating lower tariff and non-tariff barriers to trade in goods - are therefore insufficient. In the multilateral trading system, there are rules governing the movement of persons who will perform services in a foreign market. While this framework is however strictly defined, it often does not apply to the labour force and is only applied to a limited extent. In this respect policy should not only deepen but also broaden to explicitly include aspects of migration.

Recommendation 2: Increase and spread awareness of foreign-born individuals' potential to promote internationalization

Although foreign-born individuals contribute to addressing problems that companies cite as barriers to internationalization, many companies appear to be unaware of the internationalization potential that these individuals possess.

The importance of foreign-born individuals' effect on internationalization has yet to be fully understood by companies; instead, the companies have actively opted to ignore this potential among foreign-born individuals.

Therefore, the business world requires greater knowledge concerning the potential that employing foreign-born individuals has in facilitating successful internationalization. Public actors seeking to promote internationalization can play an important role in this respect. The information provided to companies involved in various internationalization support operations should also include information, facts and

examples that illustrate how companies can benefit from hiring foreign-born individuals – or otherwise exploit foreign-born human capital – in terms of simplified and more successful internationalization.

In addition to generally encouraging internationalization in the business community, an increased awareness of this issue could also provide Swedish firms with a competitive edge in rapidly growing markets, where many of Sweden's foreign-born residents have their roots.

Moreover, this could increase labour force participation among foreign-born individuals at large. The demand for workers with international expertise and experience should in turn result in reduced exclusion and increased foreign trade and investment. This is particularly the case for trade in services, which is increasingly important for the Swedish economy.

Recommendation 3: Address foreign-born individuals' skills, training and contacts

Foreign-born individuals' potential to promote internationalization should be strengthened by better exploiting their existing skills and education and by improving their opportunities to sustain networks and contacts in their countries of origin. Foreign-born individuals' ability to influence the internationalization of companies appears to operate through the dissemination of information and the provision of businesses opportunities through networking and contacts. This ability is thought to be higher among educated people. Thus it is possible to maximize foreign-born individuals' potential by better utilizing their education, for example, by accelerating the validation of previous skills, improving matching between education and work or providing further education. It is important to encourage foreign-born individuals to maintain their networks after they immigrate to Sweden. It may also be sensible to investigate the possibilities to facilitate and perhaps even encourage circular migration, i.e., the movement of persons back and forth between countries, although further research is needed in this area.

An additional lesson concerns foreign-born individuals who are residing in Sweden temporarily, for example visiting researchers and foreign students at universities and colleges. These individuals possess an ability to serve as bridges between Swedish companies and their home countries. Their potential thus extends beyond the contribution they offer to the Swedish Academy. Therefore, it is important to

provide greater access to permanent residence in Sweden to foreign academics, experts, entrepreneurs and investors. Foreign graduates should be better able to apply for jobs or start businesses even after their education has formally ended.

Recommendation 4: Facilitate the internationalization of businesses launched by foreign-born individuals

In Sweden, approximately one in eight small businesses are launched by a person of foreign origin (Swedish Agency for Economic and Regional Growth, 2012). Among young entrepreneurs, this share is even higher. Most companies operated by persons with foreign backgrounds are small and primarily operate in the hotel, business and law, and finance industries. As an example, over half of the companies in the hotel and restaurant industry are operated by individuals with foreign backgrounds, whereas the corresponding proportion is vanishingly small in manufacturing, in which nearly all companies are operated by persons with Swedish backgrounds.

Most foreign-born individuals in Sweden who run companies operate in industries that do not traditionally exhibit a high degree of internationalization. Nevertheless, there is no noticeable difference between companies managed by persons with foreign or Swedish backgrounds with respect to imports and exports. In both groups, approximately 12-13 percent of the companies engage in exporting (Swedish Agency for Economic and Regional Growth, 2011). One interpretation of this is that the foreign-born entrepreneurs are exporting to a greater extent than what would be expected based on the sectors in which they operate.

The statistics on entrepreneurs with foreign backgrounds offer an indication of these individuals' potential to promote internationalization, which is not limited to employment in existing Swedish companies. They can also promote trade through entrepreneurship.

However, there is something of a paradox in that foreign-born self-employed individuals are primarily active in industries with a lower average potential for internationalization, and in comparison with those born in Sweden, these foreign-born entrepreneurs are more likely to regard their market as local than national or international.

A potential explanation is that companies managed by persons of foreign and Swedish descent face different types of barriers to internationalization. There are data suggesting that foreign-born entrepreneurs face particular barriers in the credit market. For instance, a survey of 8,000 companies revealed that 53 percent

of entrepreneurs of non-European descent who sought loans were rejected compared with 25 percent of entrepreneurs with a Swedish background (Aldén and Hammarstedt, 2014).

Policymakers should therefore consider interventions to encourage foreign-born entrepreneurs to increase their focus on international business by identifying and simplifying regulations and reducing other restrictive barriers.

Improving the opportunities for foreign-born entrepreneurs to obtain credit to align their operations with international business represents an effective strategy to utilize the potential the foreign-born individuals have to increase the internationalization of Swedish business. One such approach could be to improve information on available offers from complementary players providing finance and financial services to small and medium sized companies.

Avenues for future research

This report suggests that to exploit the full potential of foreign-born individuals to promote internationalization, employment needs to be further increased among the foreign-born segment of the population. In this respect, it is important to increase knowledge regarding the importance of foreign-born individuals for firm internationalization. The research remains in its infancy, and there are several aspects that have yet to be analysed. Therefore, there is particular value in further research investigating the role of foreign-born employees within companies.

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