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SMES, FDI AND FINANCIAL CONSTRAINTS

WOUTER DE MAESENEIRE

TINE CLAEYS

Tine.Claeys@vlerick.be

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Erasmus University Rotterdam

TINE CLAEYS

Vlerick Leuven Gent Management School

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Contact:

Tine Claeys

Vlerick Leuven Gent Management School

Tel: +32 09 210 97 73

Fax: +32 09 210 97 00

Email: Tine.Claeys@vlerick.be

ABSTRACT

This paper explores the problems experienced by small and medium-sized enterprises (SMEs) with international ambitions in gaining access to debt and equity finance for foreign direct investment (FDI) projects. We develop several arguments why such small businesses are expected to face severe financing constraints for foreign investments and provide an explorative empirical analysis of these issues for a sample of thirty-two Belgian SMEs. We find that the market of FDI finance for SMEs is subject to considerable capital market imperfections. The information problems, lack of collateral, the home bias of financiers and the capital gearing method used by banks to evaluate small firms' foreign projects give rise to financial constraints. The FDI finance gap hinders SMEs in their internationalization strategy and negatively affects their economic performance.

JEL CLASSIFICATION CODES: F21; F23; F34; G32; M13

KEYWORDS: small business financing; SMEs; FDI; internationalization; financing constraints

TOPIC OF THE RESEARCH: Small Business Finance and Accounting; Internationalization and International Entrepreneurship

INTRODUCTION

A remarkable and extremely important business phenomenon of the 20th century was the internationalization of large and small as well as established and new venture firms (Sapienza, Autio, George, and Zahra 2005). Next to the fact that young and small firms increasingly tend to internationalize, another novel element of the globalisation trend has been the impressive rise in foreign direct investment (FDI). Yet, it is widely acknowledged that small and medium-sized enterprises (SMEs), in general, are subject to substantial financing constraints[1], which may potentially hinder exploiting their full growth potential. In this paper, we examine if SMEs that invest in foreign countries face even more severe finance constraints.

Nowadays, the majority of SMEs in almost all industries face growing competition due to internationalization (European Commission 2003a). Even primarily domestically oriented SMEs must operate internationally in order to guarantee their competitiveness and viability (Etemad 1999). During the most recent years, SMEs have taken up an increasingly active international role (Oviatt and McDougall 1994, 1999). As the world economy is becoming gradually more integrated, internationalization and FDI activities are likely to gain further momentum (Lu and Beamish 2001). A financial environment that supports SMEs' growth is an indispensable condition for the success of small businesses. By extension, inadequate access to external finance improperly hampers economic growth and welfare.

Many countries spend substantial sums of public money to moderate equity and debt gaps that are assumed to be present, particularly among small firms. A wide range of policy schemes, such as direct loans, interest subsidies and loan guarantees, have been established to alleviate finance rationing of SMEs (Cressy 1996; European Commission 2003a). FDI credits for SMEs are available in several countries, which suggest the existence of capital market imperfections for international investment. However, apart from anecdotal evidence, there is little empirical verification of the alleged FDI finance gap. Notwithstanding the huge relevance and economic importance of foreign investment, FDI financing decisions in SMEs have received comparatively little academic attention. Interest in large mature multinational firms as the unit of analysis dominates the international business literature (Coviello and McAuley 1999). Furthermore, most research on internationalization does not focus on FDI but

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[1] Financing constraints are present when a firm is not able to raise a sufficient amount of finance in time at a fair price that reflects the true risk of the project/company financed.

on other types of international activities, like export, or focus on internationalization problems experienced by specific companies, for instance high-tech firms.

Whether SMEs that pursue FDI activities indeed experience these hypothesized financing gaps is an important research question, as it is widely known that financial constraints have real impact. For instance, capital market imperfections negatively affect the number of entrepreneurial initiatives (Evans and Jovanovic 1989), drive down firm growth and economic viability (Bates 1990; Holtz-Eakin, Joulfaian, and Rosen 1994b). Financing constraints that SMEs face for their foreign investments may severely hurt their growth potential. Obtaining sufficient financing serves as a buffer against unforeseen setbacks and allows SMEs to explore and exploit a broad range of challenging foreign investment activities (Westhead, Wright, and Ucbasaran 2001). SMEs that suffer from financing constraints will rather internationalize in less capital intensive ways, and rather export than opt for FDI; hence, they will be inhibited to exploit their full growth prospects (Stopford and Wells 1972).

For SMEs, attracting external financing for domestic projects already presents a challenge. We conjecture that the extra risks that foreign projects include, together with the increase in informational problems, result in a failure of the private market to finance FDI projects for SMEs. We argue that many of the financing difficulties are similar in nature to those experienced by firms seeking finance for R&D projects: volatile returns, asymmetric information and a lack of collateral cause SMEs to have poor access to debt for their FDI projects. Moreover, financiers are likely to suffer from a home bias and the evaluation methods used by banks to assess these projects may present a further impediment to attracting finance.

In order to obtain insight in the issues that SMEs face in attracting FDI financing, we provide an explorative empirical study with both the demand and supply side of FDI finance. We have interviewed thirty-two Belgian SMEs that (consider) carry(ing) out FDI; in addition, we have interviewed five banks and five venture capitalists. Based on the interviews with the SMEs, we have composed a questionnaire that was sent to the very same SMEs that have been interviewed. This allowed us to obtain a more complete understanding of all FDI financing issues these firms are confronted with. Belgium offers an interesting setting to carry out this study as international business research has highlighted that firms from small countries have a lengthy tradition and noticeable experience in internationalization (Jones 1996). Moreover, the financial environment in Belgium is typical for Continental Europe: a bank-based system, with relatively underdeveloped capital markets, and a rather immature venture capital industry.

We find considerable support for our proposition. Severe capital market imperfections exist for financing SMEs' foreign projects and prevent small firms from realizing their full growth potential. Our study contributes to the literature in a number of ways. To our knowledge, this is the first academic article on SME-FDI finance. We provide insights in the financing of FDI by small firms and develop theoretical arguments for the financing constraints they face for investing abroad. We document the existence of these alleged financing gaps and explore their nature.

This paper is structured as follows. The next section reviews the literature on financing constraints and FDI, and develops our proposition. Subsequently, we describe the methodology and sample used. Next, we present the results of our empirical research. The paper ends with a discussion of the findings and potential avenues for future research.

LITERATURE REVIEW AND PROPOSITION DEVELOPMENT

In this section, we first review the literature on financing gaps for large and small firms and on the effects of internationalization/foreign investment on firm performance. Then, we combine elements from both reviews in order to develop why we hypothesize severe financing constraints to be present for SMEs that want to carry out FDI.

Financing constraints for large and small firms

An extensive literature documents the relationship between internal resources and firm investment (Hubbard 1998; Harrison and McMillan 2003). In business surveys companies repeatedly allude to the lack of external finance as a major obstacle to their investment and innovation activities (Harhoff and Körting 1998). These findings suggest the presence of finance rationing phenomena, which are typically considered as problems of moral hazard and adverse selection due to information asymmetry (Akerlof 1970; Leland and Pyle 1977). Jaffee and Russell (1976) and Stiglitz and Weiss (1981) argue that banks may ration credit rather than increase interest rates to clear the market as the latter may deter good borrowers and result in incentive problems. In equity markets, Myers and Majluf (1984) describe why firms may need to sell new stock at a discount ('lemon' premium). Financing constraints occur for various types of firms and/or projects, for example for starting entrepreneurs (Evans and Leighton 1989; Holtz-Eakin, Joulfaian, and Rosen 1994a) and innovative projects like R&D (Arrow 1962; Himmelberg and Petersen 1994; Hall 2002). Fazzari, Hubbard, and Petersen

(1988) even find evidence of significant capital market imperfections for publicly traded manufacturing firms in developed markets.

Several empirical studies report evidence that financing constraints have a greater impact on the investment behaviour of small firms (Hall 1992; Berger and Udell 1998) and that SMEs' growth is determined by their access to internal finance (Spence 1979; Moore 1993). The European Commission has acknowledged the financing difficulties, both for equity and debt, of smaller firms and recognizes the existence of a market failure due to information problems and transaction costs (European Commission 2003b). As a result of the financing gaps, small firms tend to rely more on self-financing, have lower liquidity and leverage, seldom issue equity, and rely more on short-term bank financing, trade credit and owner loans (Bates 1971; Chittenden, Hall, and Hutchinson 1996). The efficient and effective provision of finance is fundamental in ensuring that SMEs can exploit their growth opportunities. A positive association exists between external finance and business performance (Keasey and McGuiness 1990). We next present a number of reasons that account for the financing issues that SMEs regularly encounter.

First, SMEs are disadvantaged in a number of aspects compared to large firms. They have a smaller pool of financial and managerial resources to survive critical periods. SMEs have a shorter expected life, may face intergenerational transfer problems and are expected to be less profitable (Pettit and Singer 1985; Ang 1992). Large firms usually have better-trained management, advantages in raising capital, more favourable tax conditions and government regulations, and can better compete for qualified labour (Brüderl and Schussler 1990; Cressy and Olofsson 1997). Empirically, failure rates are notably higher for SMEs (Brüderl, Preisendörfer, and Ziegler 1992).

Second, agency and asymmetric information problems may be more pronounced for small firms. Agency costs can expected to be higher as a small business manager is likely to put his own and his firm's interest first. Additionally, solutions to agency problems are more costly to SMEs, thereby raising the transaction costs between small businesses and their financiers. Moreover, the fixed cost element of transactions puts small firms at a disadvantage (Coase 1937). Monitoring SMEs is more difficult and expensive as information on them is less easily available, they have less credit history, are subject to less rigorous reporting requirements and the quality of their financial statements may vary (Pettit and Singer 1985). Furthermore, employing bonding methods like incentive schemes may be complex for SMEs (Michaelas, Chittenden, and Poutziouris 1999). All these elements result in SMEs often facing difficulties in signalling their creditworthiness.

For SMEs, access to external equity has long been identified as a problem (Macmillan 1931; Radcliffe 1959; Bolton 1971; Wilson 1979). In general, SMEs do not have access to capital markets. First, a stock market flotation is relatively more expensive to arrange for smaller issues (Lee, Lockhead, Ritter, and Zhao 1996). Second, initial public offerings of smaller firms are subject to higher underpricing (Buckland and Davis 1990). Venture capitalists (VCs), as specialized financial intermediaries, may mitigate the substantial information problems that prevail in SMEs. However, Sahlman (1990) presents evidence that venture capital (VC) is very expensive. In addition, VCs back only a tiny fraction of all new ventures.[2] Besides, the VC market in Continental Europe is relatively underdeveloped compared to Anglosaxon countries. Moreover, due to the high fixed costs of monitoring, especially small businesses are not very attractive to VCs (Scholtens 1999). Furthermore, despite the scarce availability and the high cost of bank loans, it has been well established in the small business literature that SME owner-managers are reluctant to sell equity to outsiders and give up independence and control (Jordan, Lowe, and Taylor 1998; Giudici and Paleari 2000). This control aversion is more important for smaller firms; obviously, this demand-side financial constraint further increases financing issues for SMEs.

As a consequence of the persistence of an equity gap for small businesses, the bulk relies for external funding upon bank debt (Binks and Ennew 1996). However, regarding bank loans, SMEs find themselves again in a deprived position compared to large firms. Small firms are more constrained in the use of control mechanisms, as collateral, long-term relationship and reputation that ease information problems. For instance, collateralization may under some circumstances contribute to attenuate credit rationing problems; collateral serves as both a signalling device to overcome adverse selection and as an incentive device to overcome moral hazard (Bester 1985). Yet, the potential to put up collateral depends on the industry and on the asset specificity of the firm. The younger and smaller a firm, the less it is able to pledge collateral. Furthermore, SMEs usually are less capital intensive than large ones. The intangibility of the assets, an important characteristic of start-up and small firms, also impedes this control mechanism (Scholtens 1999). Pledging personal collateral in the form of a guarantee offers only a partial solution as it is limited in supply (Giudici and Paleari 2000). Despite the fact that SMEs generally lack sufficient collateral, lending to SMEs is more often based on pledging collateral (Chittenden, Hall, and Hutchinson 1996).

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[2] For instance, in 1997, a record year for US venture disbursements, 707 companies received first-round venture financing, while 885,000 businesses were started in the US (Lerner 1999).

Internationalization-FDI and firm performance

While exporting is still very significant, during the last decade internationalisation has become a much more differentiated activity that is critical for achieving competitiveness. 30% of European SMEs have foreign supply relationships, 18% export, 3% have collaborative relationships with foreign firms, and 3% have established foreign subsidiaries (European Commission 2003a). Some of the principal drivers for the growing internationalization of SMEs are rooted in political, economic and technological evolutions. Numerous countries opened up their economies during the 1990s; trade and investment liberalization programs far outnumbered more restrictive measures. An increasing number of people has become more internationally mobile. Furthermore, the rising homogenization of markets in distant countries has made international business more accessible for everyone (Madsen and Servais 1997). Spectacular increases in the speed, quality and cost efficiency of international communication and transportation have greatly reduced the transaction costs of multinational business (Porter 1990). Consequently, exploring and exploiting international business opportunities is no longer the preserve of large corporations (Oviatt and McDougall 1994). An ever quicker economic and technological pace urges typical SMEs to lever their competencies abroad, especially when they operate in undersized domestic markets (Etemad 2004). Few small firms can avoid foreign competition and many of them are thus imposed to adopt an international perspective (Ohmae 1990).

Many advantages associated with internationalization are well documented in the literature. Geographic diversification offers a range of exploration and exploitation benefits (Lu and Beamish 2001). Internationalizing firms may realize economies of scale and scope (Hymer 1976), reduce fluctuations in revenue by spreading investment risks over different countries (Kim, Hwang, and Burgers 1993), reduce costs and boost revenues by increasing market power (Kogut 1985). They have the opportunity to exploit market imperfections in the cross-border use of firm-specific assets (Caves 1971). FDI in specific permits the leverage of various ownership and/or location-based advantages such as a competitively priced labour force, access to critical resources and development of new capabilities (Dunning 1980; Lu and Beamish 2004). It allows to exploit firm-specific advantages or technological superiority (Vernon 1966), and to reduce transaction costs (Williamson 1975).

Yet, foreign investment may be risky. A foreign firm may face some specific disadvantages like governmentally instituted barriers to trade and an incomplete understanding of local laws, language and business practices (Oviatt and McDougall 1994).

Many of these difficulties may be associated with the liability of foreignness (Hymer 1976) and newness (Stinchcombe 1965). A new subsidiary faces similar challenges as a start-up, as it needs to build business relationships with stakeholders, establish its legitimacy and train new employees to staff new operations. Due to political, economic, legal and cultural differences, an internationalizing firm is required to adapt its resources developed in a domestic context (McDougall and Oviatt 1996). FDI requires a fundamental departure from current business practices and increases the risks of failure (Miller 1983; Sapienza, Autio, and Zahra 2005). On top of increased political (Adler and Dumas 1975; He and Ng 1998) and exchange rate risk (Solnik 1974), Armstrong and Riddick (1998) argue that international firms suffer from greater agency costs and information asymmetry. It is more difficult to monitor managers in international markets due to geographical constraints, cultural, language and legal differences, multi-country financial statements and multi-country auditors (Lee and Kwok 1988; Burgman 1996). Additionally, similar to product diversification, transaction costs increase with the degree of geographic diversification (Williamson 1975).

SMEs, FDI and financing constraints

Although a number of papers have revealed that exporting SMEs frequently face a lack of capital to finance their exports (Bilkey and Tesar 1977; Hook and Czinkota 1988; Crick 2004), there is not a single study in the literature that investigated the financing constraints SMEs experience when pursuing FDI. However, a survey by the European Commission showed that in particular SMEs that engage in outward internationalization activities may confront a shortage of capital (European Commission 2003a).

Prior research has documented a strong predisposition of equity investors towards geographically and culturally proximate investments (Feldstein and Horioka 1980; Coval 1999; Grinblatt 2001). This home bias is claimed to be due to cognitive bias towards familiar investments (Huberman 2001) and lower information costs (Merton 1987). Similarly, VC firms (and banks) rather invest (lend) in geographical areas close to their home base. As geographical distance rises, reducing information asymmetries between firm and financiers becomes more challenging (Sorenson and Stuart 2002). Moreover, VCs and banks who invest outside their home country need to invest resources in order to understand the local legal and institutional environment (Johanson and Vahlne 1977).

We argue that many of the issues that firms face in attracting capital for FDI are equivalent to those experienced by high tech firms or for financing an R&D project. Comparable to high tech investments, FDI is characterized by highly variable returns, asymmetric information and a lack of collateral; as a result, access to debt is likely to be poor. First, returns to FDI are volatile and skewed. As creditors do not share in the upwards states of nature, they only care about the left tail of the distribution of returns (Stiglitz 1985). When borrower returns are decidedly uncertain, extensive use of debt may result in expected losses for lenders (Carpenter and Petersen 2002). Second, information asymmetries between firms and potential investors are expected to be more pronounced for FDI projects. Foreign investments are hard to evaluate and insiders will likely have much better information than outsiders about the project's prospects. As a result, creditors may rationally decide to ration credit (Jaffee and Russel 1976; Stiglitz and Weiss 1981). Third, like R&D investments, FDI often has limited collateral value. Foreign investments repeatedly incur sunk costs with little or no salvage value at the initial stage, such as expenses of foreign market analysis, legal consulting services, translation of documents, adapting products to host markets, travel expenses or the costs of setting up a foreign sales channel (Horst 1972; European Commission 2003a; Fryges 2004). FDI frequently involves intangible assets or firm specific assets, and therefore provides little or no collateral value, as there is a higher risk of losses for creditors since the assets involved cannot simply be traded on other markets (Williamson 1975). A large body of literature demonstrates the importance of collateral for debt financing (Bester 1985; Berger and Udell 1990; Boot, Thakor, and Udell 1991). Empirical evidence suggests a negative relationship between a firm's intangible assets and leverage (Gompers and Lerner 1999). For high tech SMEs, next to all long term debt is secured (Carpenter and Petersen 2002). Thus, the rather limited collateralizability of FDI assets restrains access to debt. SMEs face even greater challenges than their larger counterparts in obtaining financing for FDI. Small firms often have internal shortages of information, finance, management time and experience (Etemad 1999). These limited resources result in a higher vulnerability to environmental changes and a lower capacity to absorb the hazards of exploring inherently risky and competitive international markets (Buckley 1989). These constraints inflate the liabilities of foreignness and of newness and make internationalization a challenge to SMEs (Lu and Beamish 2001).

Furthermore, supply-side financial constraints, in particular credit rationing, for FDI are likely to be worse for small firms than for large businesses. The so-called home bias of VCs and banks is due to information costs. Given that the costs of collecting and processing

information are to some extent fixed, they will tend to be more significant for SMEs. Even more importantly, the methods of evaluation used by banks to assess small business loans may give rise to financial constraints. In perfect markets all valuable projects should be funded (Merton 1987); therefore, the income gearing approach (used for large firms) to bank lending is preferable to the traditional capital gearing (used for small firms) method since it relies on the firm's future performance rather than on the provision of collateral. However, this requires the bank to understand how the firm and its markets operate; for banks, the assessment of future cash flows of FDI projects is often unfeasible (Binks and Ennew 1996). Similar to high tech investments, judging the prospects of an SME's foreign investment might be challenging for a bank. High tech SMEs typically complain with banks of their limited competency in correctly evaluating their business potential and about the excessive amount of warranties required; smaller firms suffer most from these problems (Giudici and Paleari 2000). Additionally, the income gearing approach requires the firm to provide the bank with up-to-date information which has been argued to be a problem. In summary, for SMEs that apply for a loan, banks usually rely on the capital gearing method; however, in case of FDI, the required collateral is often lacking. As an alternative to providing collateral, developing good working relationships with banks would allow SMEs to reduce information asymmetries and may induce banks to conduct relationship based rather than transaction based lending. Yet, SMEs often fail to achieve this. The empirical evidence suggests that SMEs are dissatisfied about the quality of service rendered by their banks and generally perceive their banking relationship as poor (Binks and Ennew 1996). By contrast, larger firms are prone to have a more established relationship with their banks, thereby enabling banks to draw on information produced in past lending transactions (Sharpe 1989).

Based on the discussion of theoretical arguments presented above, we formulate our proposition: *"SMEs experience more severe financing constraints for their FDI than for their domestic projects"*.

METHOD AND SAMPLE DESCRIPTION

Method

In order to empirically study our proposition, we have interviewed both the demand and supply side of SME FDI finance in the Flanders region of Belgium: thirty-two SMEs[3] that are involved in FDI projects, five banks and five venture capitalists. To examine FDI finance issues, it is imperative to choose a market in which the majority of SMEs operate in multiple countries. Smaller countries with open economies but small domestic markets are more internationalized (European Commission 2003a). Multicountry activity is widespread in small European countries like Belgium, even among independent, owner-managed companies (Sapienza, De Clercq, and Sandberg 2005).

Accordingly, our population contains all Belgian SMEs that pursue foreign direct investments. In our study, we are only interested in productive FDI; thus, for instance, opening up a foreign sales office is not included as this requires less capital and has a different risk profile than true productive foreign investments (for example, set up a new plant). It is infeasible to find a listing of all SMEs that pursue productive FDI, so we have contacted several sources in order to compose our sample. The Belgian Corporation for International Investment[4] (BCCI), the Entrepreneurship, Governance and Strategy Competence Centre at the Vlerick Leuven Gent Management School, the Cabinet of Economic Affairs, and sector federations like Agoria[5] and Febeltex[6] all provided us their records of companies planning to invest in FDI. Flanders Investments & Trade (FIT), a government agency promoting sustainable international business, forwarded us a list of firms that were registered for participating in a seminar on financing and insurance of foreign investments. Also, we asked the SMEs that we interviewed, if possible, whether they knew other SMEs involved in foreign investments. Despite the fact that we could count on several sources of information, it turned out to be hard to identify SMEs suitable for our research. First, smaller firms are notably less internationalized than their larger counterparts, and the difference is particularly manifest for

[3] According to EU directives, SMEs are firms that employ less than 250 people, report sales of less than 50 million euro or alternatively report an accounting asset value of less than 40 million euro. Additionally, the SMEs in our sample had to comply with an independence criterion: no more than 25% of their equity capital must be owned by one or several companies (see Giudici and Paleari 2000).
[4] BCCI is a government-supported investment company whose main objective is to co-invest and to provide long-term co-financing of foreign investments by Belgian companies.
[5] Agoria is Belgium's largest employers' organisation and trade association; it represents companies active in the technology industry.
[6] Febeltex is Belgium’s employers' organization of industrial textile manufacturing companies.

more complex forms of internationalization like FDI (European Commission 2003a). Second, a large part of FDI does not involve productive investments.

We identified 130 firms that were considered to be SMEs carrying out productive FDI. An email was sent to all these firms informing them about our research project. Afterwards, all firms have been contacted by phone and we checked whether they met our sample criteria. 32 SMEs met our requirements and were willing to cooperate. We have interviewed the owner/manager of each firm. Financial data and other firm characteristics were looked up in advance through annual reports and the firm's website. Semi-structured interviews were conducted with the respondents, lasting between 1 and 1.5 hours. These enabled us to develop a questionnaire, which we pretested with SME experts and academics and with one SME owner. After reviewing the questionnaire, it was sent to all SME owners previously interviewed. Next to providing general information about the SME and its foreign projects, owner-managers were asked to report how they finance FDI and to score a broad range of statements or items on a 5 point Likert scale (with 1=totally disagree, and 5=totally agree). The goal of the questionnaire was to propose a full range of statements to the SME owners in order to explore their FDI financing issues. 23 questionnaires have been filled out and returned to us. In addition to examining the demand side of FDI finance for SMEs, we also explored the question from the perspective of the supply side, as a check on the validity of the results obtained with SMEs. SMEs might have reasons to report financing difficulties and exacerbate the extent of the financing constraints they face, for instance to induce the government to provide cheap FDI finance. Five banks and five venture capitalists have been interviewed; we spoke to both large and smaller banks, to banks with a general focus and with a specific focus on small and medium sized businesses. Similarly, we have interviewed large and small VCs with varying investment profiles.

Description of the sample

Our sample is active in a wide range of industries. Table 1 provides an overview according to the Nace Bel industry classification scheme. Several firms operate in more than one industry.

Insert Table 1 about here

Some important characteristics of the firms that returned the questionnaire are reported in Table 2. The average number of employees at the end of 2005 was 165. Average sales totaled 22.1 million euro, while the mean total assets amounted to 14.0 million euro. By the end of 2005, two firms in our sample have become quite large and do not meet the SME criteria any longer. However, we have explicitly asked these firms to talk about their FDI finance issues during the time they were small or medium sized. Moreover, when they carried out their most recent international investment, they still met all SME criteria.

Insert Table 2 about here

All of the firms surveyed export. On average, 47% of their sales are generated in other countries. 96% of the SMEs have foreign suppliers; 43% of their purchases are made abroad. We asked the SMEs about their most recent foreign direct investment. The average investment equals 1,482,985 euro (median: 575,000 euro), and is mainly invested in property, plant and equipment. Table 3 gives an overview of the country of investment. Continental and Eastern Europe and China are the two most popular regions. Half of the sample already had experience with FDI before their latest transaction.

Insert Table 3 about here

The SMEs in our sample indicated that they pursue FDI projects to reduce transportation costs, import/export taxes, benefit from incentives offered by the host country, enhanced payment processing and sales potential, favourable tax conditions, and to create a better access to neighbouring countries. FDI also enables easier adaptation to local cultural, political and economic conditions, and permits to avoid the home country's regulatory burden and high costs of infrastructure or labour.

Our respondents indicated a mean risk score of their latest FDI project (compared to a similar domestic project) of 3.24, which suggests that the foreign investment is not perceived as particularly risky. Moreover, as the SMEs acknowledge the potential risks of FDI they try to control them by a profound analysis of the foreign project. Though modern communication tools like internet and webcams allow better monitoring of the foreign investment, SMEs prefer to invest in geographically proximate countries. Several firms noted that a 'do nothing strategy' is risky as well in the current economic environment.

RESULTS

This section reports results and analyses drawn from the surveys, together with qualitative information provided during the interviews. We start by providing a summary of the results of our sample's financing constraints. Subsequently, we elaborate upon the financing sources for FDI and any financing constraints perceived. Finally, we present our findings obtained from interviewing the supply side of FDI finance.

Summary of the results

As shown in Table 4, the SMEs in our sample report facing considerable financing constraints for FDI projects (mean score: 3.61), which negatively impacts their growth potential (3.57). The same SMEs report limited financing constraints for their domestic projects (2.26). They claim that the problems experienced for foreign investment are more severe than for large firms (4.00), and than for attracting finance for domestic projects (3.77). For foreign projects, SMEs make use of suboptimal and expensive sources of finance to a larger extent than for domestic projects since they cannot attract standard types of financing (2.74 versus 1.82). Overall, small firms observe a failure in the private market to finance their FDI projects (3.94).

Insert Table 4 about here

We have collected data about owner-managers' characteristics, like education, working experience, age, and about the SME ('s FDI), like founding date, industry, size, number of employees, region of investment and previous FDI activity. We could not detect any significant relationships between these factors and SMEs' FDI financing constraints due to our limited sample size.[7]

[7] For instance, we find a (statistically insignificant) negative relationship between proxies for firm size and the FDI financing difficulties reported, and a mitigating effect of previous experience with foreign investment on SMEs’ financial constraints regarding international investment.

Financing of the FDI project

We have analyzed how SMEs finance their foreign investments; we discuss impediments to the use of local/domestic bank finance, and to raising internal/external equity. At the end, we present our findings on the use of government grants and partnerships.

Internal financing. 42.9% of the respondents indicate that their most recent FDI project was entirely funded by internal cash flows. Furthermore, 50.0% mainly finance their latest foreign investment with internal funds. Thus, generating sufficient internal funds is critical in financing FDI. These results may already hint to the presence of financing constraints: the relationship between internal cash generation and investment activity is a common measure of financing gaps in the literature (Hall 2002). Simply focusing on the mean score reported by our respondents might be misleading and may hide the fact that FDI financing issues are not homogenous for all SMEs. A score of around 3 may be the result of averaging out scores of 1 (no issue at all for some firms) and scores of 5 (a severe issue for other firms). Thus, we also examine the percentage of sampled SMEs that report fully agreeing with a statement.

Table 5 indicates that many of our respondents would have trouble financing the FDI project in case of insufficient internal finance (mean score: 3.74; %score 5: 39.1%), and that they more strongly depend on internal financing for foreign than for domestic projects (3.71; 38.1%). Finally, a larger wedge between the cost of external and internal financing for FDI is also reported (3.58; 26.3%).

Insert Table 5 about here

External financing. 78.3% of the SMEs uses external financing for its FDI projects. Bank financing is the most popular source of funds: 39.1% obtain local bank finance in the foreign country, while 65.2% attract domestic bank finance.

- Local bank finance: Many SMEs consider local bank financing but state that interest charges (4.05; 42.9%) and collateral requirements (4.16; 47.4%) are high (see Table 6). Sometimes, local banks refuse to accept domestic guarantees (2.63; 18.8%). Moreover, in some countries bank regulation is quite restrictive (3.37; 26.3%), or the bank sector is not well enough developed (3.26; 36.8%). For instance, only short or medium term loans are offered,

even for the acquisition of long lived assets like buildings. Leasing does not exist in some foreign countries. China for example is reported to have a very restrictive banking system, in which a substantial equity commitment is required for the bank to consider granting a loan. Furthermore, several firms report that obtaining local bank financing is a time consuming process (3.61; 33.3%). In the interviews, some SMEs stated that they are hindered by a lack of reputation and contacts in the local bank market.

Insert Table 6 about here

- Domestic bank finance: A major impediment to attracting domestic bank finance for FDI is that the underlying assets often cannot serve as collateral for domestic banks (4.22; 50.0%, see Table 7). This is partly due to their specificity and the resulting low collateral value (3.20; 25.0%). Domestic banks repeatedly require (further) personal collateral, which of course is limited by nature or may already be exhausted (3.28; 50.0%). The domestic bank usually refuses to lend to the foreign subsidiary for the FDI project and lends to the parent firm, thereby shifting the credit risk to the parent (3.79; 31.6%). The limited equity position of the firms is another important obstacle for obtaining FDI bank finance (3.14; 28.6%); however, raising equity with existing shareholders for a typical family-owned private SME is not always feasible, while attracting external equity is often undesirable. Next, domestic banks are not really interested in FDI and have a specific domestic focus (3.32; 31.6%), are reluctant towards foreign projects because of monitoring issues (3.62; 38.1%) and are not always capable of accurately assessing the risks of FDI (3.20; 25.0%). Furthermore, domestic banks frequently only consider lending for acquiring fixed assets, and not for any required start up costs, market studies, document translation, product adaptation, consulting services or business trips (3.28; 27.8%). For many SMEs, these high costs of internationalization present a serious barrier to foreign investments (European Commission 2003a). During the interviews, not only the refusal of the FDI loan request was mentioned by some SMEs to be problematic, but also the long search for financing and the long period of time before a loan request is approved. While searching for funds, SMEs cannot completely focus on the core business activities and the optimal timing and implementation of FDI may be jeopardized.

Insert Table 7 about here

Our respondents claim to be dependent on banks for financing both domestic and foreign investments (3.65; 21.7%) and that banks, on top of interest fees, charge other (fixed) costs that are more important for SMEs (3.71; 35.3%, see Table 8). Banks base their credit decision for foreign projects to a higher degree on collateral, and not on the projects' profitability and cash flows, than for domestic projects (3.63; 36.8% vs. 3.45; 18.2%). For small SMEs, banks require more collateral (4.50; 60.0%). If banks judge that the FDI's risk is excessive, they will rather ration credit than raise interest rates (4.24; 52.4%). This is in line with credit rationing theories: the risk profile of foreign projects does not lead to higher interest rates due to the perverse effects this would bring along, but rather to higher collateral requirements and credit rationing. For large firms, banks tend to base their credit decision on the FDI's profitability (3.64; 28.6%). Moreover, larger firms have some possibilities to collateralize the FDI assets (3.50; 30.0%).

Obtaining domestic bank finance for exporting already presents an issue for some SMEs. However, attracting bank finance for FDI projects is even more difficult and in some specific countries even impossible (4.13; 53.3%). As could well be expected, banks are more willing to provide funds for FDI projects in geographically proximate countries. For banks, there seems to be a preference for Eastern Europe over Asia (3.42; 16.7%). Attracting finance for Africa-based projects is next to impossible (4.25; 62.5%), while this is rather straightforward for US projects (2.00; 0.0%). Interestingly, 31.3% of the SMEs admit that they sometimes do not even apply for bank credit for a valuable though complex FDI project as they are convinced it will not be granted; this means that the financing constraints reported by our SMEs might be an underestimation as credit requests for more complicated or hard-to-explain foreign projects may never have been submitted.

Insert Table 8 about here

According to the SMEs surveyed, the key factor driving the bank's credit decision is the firm's ability to pledge collateral (4.65; 70.0%, see Table 9). Raising new equity is also helpful in attracting FDI bank financing (4.30; 50.0%) as it facilitates respecting credit limits and a minimal solvency level (4.17; 38.9%). Having a good and trustworthy relationship with the SME is critical as well (4.30; 65.0%). Other (expected) relevant factors are the country of investment (4.40; 50.0%), the presence of a strong currency (4.05; 30.0%), the realism and feasibility of the FDI's business plan (4.20; 50.0%), the risks of the FDI project (4.14; 52.4%),

the SME's management team (4.00; 42.9%) and financial performance (4.33; 47.6%). An SME experienced in FDI will probably have better access to FDI bank finance (3.53; 31.6%), and obtaining bank finance is easier when the domestic bank has a physical presence in the local country (3.74; 26.3%).

Insert Table 9 about here

- Equity finance: 50.0% of the respondents make use of new equity raised with existing shareholders. Existing shareholders are claimed to be capable and willing to provide new equity financing. However, though the scores reported are not particularly high, raising equity with external shareholders seems to be more difficult (2.90; 15.0% vs. 2.67; 14.3%) and the respondents may in some cases be reluctant to do this (3.47; 36.8%, see Table 10). Even 28.6% of the respondents totally agree that raising equity from new stockholders is the last financing option they would consider.

Insert Table 10 about here

As raising new equity with current shareholders may not be an option, SMEs might try to attract business angel or venture capital finance. Not a single respondent makes use of business angel funds, and just two have ever applied for this source of finance. Major obstacles to business angel finance are SMEs' lack of knowledge about this source of finance (3.50; 25.0%), the perceived high levels of control and monitoring required (3.50; 18.8%), the cost of business angel finance (3.33; 26.7%) and the fact that the requested amounts of finance are sometimes too large for business angels (2.62; 23.1%, see Table 11). Numerous SMEs are reluctant to attract business angel finance (3.19; 31.3%).

Insert Table 11 about here

Two SMEs in our sample have attracted venture capital in order to finance their FDI projects; however, about half of our sample (52.2%) has ever applied for VC finance. Rather than not being capable of raising venture capital for their FDI projects (2.20; 13.3%), our respondents show some unwillingness to attract VC (3.06; 35.3%, see Table 12 and 13). There

is a substantial preference for financing by an industrial partner over VC financing (4.00; 40.0%), and VC is to some extent considered as a last resort (3.33; 27.8%). SMEs do not feel that VCs are not open to investing in their firm or its FDI projects. By contrast, a VC is more interested in SMEs with foreign investments as this may boost returns and enhance exit opportunities (4.19; 43.8%). In contrast to the results for banks, firms do not think that VCs lack the skills to accurately assess their domestic and foreign investment projects. The major obstacles reported by our sample to avoid VC finance is that VC is too expensive (3.44; 31.3%), especially given the low risk they are seeking (3.60; 40.0%), the VC's option to sell off its stake in case of bad results (3.29; 41.2%), and the SME's fear of not being able to buy back the VC's shares if needed (3.83; 38.9%). Moreover, VCs are reported to desire a too quick exit (3.72; 33.3%), to sometimes employ aggressive investment contracts (3.13; 18.8%) and to require much control/monitoring (3.26; 15.8%). Finally, some firms are not well informed about VC financing (2.53; 11.8%).

Insert Table 12 and Table 13 about here

- Government grants: 30.4% take up some government subsidies in the host country, while all firms in our sample make use of government grants in the domestic country.[8] Financial government support for SME FDI projects is definitely most welcome (4.36; 68.2%, see Table 14). Several firms report that, without government support, it is very doubtful that some of their FDI projects could have been executed (2.77; 27.3%). Our respondents argue that it is the government's duty to help resolve the private market's failure to finance SMEs' FDI projects (3.59; 31.8%). Critical in government support is that no collateral or guarantees are required (4.05; 47.4%). Another way the government can help SMEs is by guaranteeing their FDI loans (3.73; 31.8%). An important indirect effect of SMEs obtaining government grants for FDI projects it that it facilitates access to private financing, due to an improved solvency position (3.79; 36.8%), but even more significantly due to the positive signal provided, for example to banks (4.00; 47.4%). During the interviews, one SME explicitly

[8] The most popular general types of subsidies in Belgium are IWT(Institute for the Promotion of Innovation by Science and Technology in Flanders)-grants, used by 47.8% of our sample, and interest subsidies, used by 39.1% of our sample. Regarding internationalization, 34.8% of the sample makes use of export subsidies, 47.8% of FIT(Flanders Investment & Trade)-support and 21.7% of BCCI(Belgian Corporation for International Investment)-support. BCCI usually provides subordinated loans and acts as a co-investor to provide long-term co-financing of foreign investments. 17.4% of our sample has received a grant from the Fund Flanders-Asia, a Flemish fund that provided support for firms investing in Asia.

mentioned that it was next to impossible to obtain bank credit, but that attracting BCCI-support enabled this.[9] Similarly, some other SMEs stated that obtaining interest subsidies and/or government guarantees were requested by banks in order to grant loans. In order to be effective, it is imperative that the government responds quickly to requests for FDI support (4.43; 61.9%). Obtaining FDI government grants/support is harder for small SMEs (4.00; 50.0%), limited amounts required (3.87; 40.0%) and for certain industries, like services (3.85; 46.2%). Next to providing financial support, the government must create an environment that facilitates and stimulates international trade, for example through the provision of information and the promotion of domestic firms in foreign countries (4.05; 52.4%).

Insert Table 14 about here

- Partnerships: In addition to providing additional resources and expertise, a domestic partner may support FDI projects financially. 21.7% has partnered up with a domestic firm for (some of) its foreign projects. Having a domestic partner slightly eases access to domestic financing (3.38; 7.7%, see Table 15).

Insert Table 15 about here

For FDI projects, partnering up with a host country firm is quite common (43.5%), as this allows benefiting from the local partner's legal, cultural and administrative knowledge. Additionally, it facilitates access to local finance (3.78; 22.2%) and local government support (3.83; 16.7%, see Table 16).

Insert Table 16 about here

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[9] Granting government subsidies or guarantees may send a positive signal to private financiers as knowledgeable government officials certify the recipient, thereby mitigating information problems that otherwise would have precluded attracting finance (Lerner 1999).

Interviews with supply side

Evidently, the SME data are self-reported. Though much secondary data used in entrepreneurship and strategic management research are self-reported (Ireland, Reutzel, and Webb 2005), we recognize the potential for bias. Therefore, we also investigated the topic from the supply side of SME-FDI finance as a robustness check on the results obtained with SMEs. The findings are in line with those gathered from the demand side.

According to the financiers, the key criteria for supplying finance for an SME's FDI project are the region of investment (political and economic stability), the SME's management (education, experience, track record), the project's cash flow potential, the SME's solvency position and its ability to pledge collateral.

An SME is considered to be more risky than a large firm and this is inflated for foreign investments. In case of trouble, it is harder for SMEs to send a manager to the host country. Internal control mechanisms and reporting tools are less sophisticated. Consequently, in order to attract FDI finance, the owner-manager and his perceived competency are crucial. For an international project, an entrepreneur requires above average management skills, knowledge of several languages and strategic vision. If the entrepreneur cannot convince the financier of its above average capabilities (even if he or she is very capable), obtaining FDI finance will be very hard. An essential element in the bank's evaluation is the project's business plan. However, for banks it is hard to judge the feasibility of international projects: they are not very familiar with other countries and cultures, and monitoring becomes more complex. As a result, the substantial information gap between bank and SME is often not bridged, thereby limiting the odds of attracting FDI bank finance, and inducing the need for collateral.

Banks admit that they often question small firms' repayment capacity and that they ask for substantial collateral; they acknowledge providing sufficient finance to established SMEs, whereas this is less evident for young firms. Though they do support export and import activities, banks are not encouraging SMEs to carry out international investments. Domestic projects are easier to evaluate, and present fewer legal issues. An excellent business plan for the foreign project is required, and even when the loan request is positively evaluated, banks tend to provide less funds than asked for. Small businesses are charged higher interest rates for FDI projects and collateral requirements are more important. In order to reduce their risk, banks invest in the parent firm, or only invest in the foreign subsidiary when the domestic parent guarantees the loan. Banks require SMEs to have stronger equity positions than large firms; in order for the bank to grant a loan for the foreign investment, new equity may have to

be raised. As mentioned before, both providing suitable collateral for an FDI project and attracting additional equity present obstacles to many SMEs.

Venture capitalists indicate that they are not eager to invest in SMEs, as the low amount of finance looked for is insufficient to justify the substantial time and efforts a deal would require. Only in case of a very high return potential, an investment in an SME would be considered. Furthermore, the number of VCs specialized in small businesses has decreased over the last few years. In order to compensate for their high (fixed) costs, VCs offer rather low valuations or unfavourable investment terms to SMEs, which therefore deem this source of finance to be rather unattractive. However, VCs willingly admit that firms with international projects offer a more interesting return potential and a wider range of exit options.

The financiers interviewed recognize that there is a failure in the private market for financing SMEs' FDI projects, and acknowledge a need for government intervention and support. Ideally, the government should bear part of the SMEs' risk and guarantee their loans. Alternatively, the government may provide subordinated loans to the SMEs or take equity stakes.

DISCUSSION AND CONCLUSION

In line with the theoretical arguments developed, we find more severe financing constraints for FDI than for domestic projects for many SMEs. The volatile returns, information problems and lack of collateral that often characterize FDI result in financing gaps. The home bias of financiers and the capital gearing method used by banks to evaluate SMEs' projects further reinforce financial constraints. Besides, SMEs are clearly disadvantaged compared to large firms. Our empirical findings support the theoretical proposition, provide an exploration into the nature of the capital market imperfections.

When internal finance is insufficient for the FDI project, a lot of SMEs often have a hard time attracting funds. Excessive collateral requirements, high interest rates or an underdeveloped banking system may preclude local bank finance. Domestic banks are often not well capable of evaluating FDI and suffer from a home bias. Furthermore, they are frequently only willing to finance fixed assets and base credit decisions on a capital gearing approach. Typically, the FDI assets cannot serve as collateral. Attracting external equity may not be available, too expensive or require giving up control. Venture capitalists are reported to offer unattractive investment terms. SMEs often rely on government grants to alleviate the

private market's failure to finance FDI projects. Next to a direct positive effect, government support provides a positive signal to private financiers. Partnerships, both with domestic and local firms are repeatedly utilized, and facilitate access to finance.

The capital market imperfections found suggest a further need to find ways of alleviating barriers to entry to the stock market for SMEs. The government should remove any lack of equity stemming from tax and regulatory frameworks (Wagenvoort 2003). Furthermore, financial institutions are required to develop creative solutions to the information problems involved in SMEs' FDI projects, rather than relying on collateral. Establishing close and long-standing relationships serves to reduce information asymmetries between borrowers and lenders as it provides the bank with a clearer understanding of the business' prospects and a better picture of the owner-manager's managerial capabilities (Berger and Udell 1995; Binks and Ennew 1996; Boot 2000). Government grants or other forms of support may mitigate the effects of the private market's failure; especially, the government's lack of a demand for collateral or its guaranteeing of SME commitments are crucial. Besides financial help, SMEs are convinced that the government should create a framework that facilitates internationalization.

Our research is subject to a number of limitations. First, the lack of public data on the key constructs required us to rely on self-reported data for many variables. We have taken various precautions to guard against any potential bias but we cannot fully eliminate the risk of biased data. Second, this study's focus on a single country, Belgium, may cast doubt on its wider validity. Still, we see no reason why the theoretical foundations for our work should obtain more fully in Belgium than somewhere else (Sapienza, De Clercq, and Sandberg 2005). Third, our sample is mainly composed of firms that have succeeded in carrying out their FDI plans. The true financing gaps faced by SMEs *considering* international investment might be even more substantial. Fourth, the size of the sample used in our study is limited, and for instance does not allow us to statistically examine the factors driving SMEs' financing constraints for foreign projects. On the other hand, given this paper's explorative nature and the fact that the population of SMEs involved in productive FDI is not large, our sample cannot be considered small at all. Resolving the limitations present in this study provides a fruitful area for further research.

To end this paper, we present some more avenues for future research. It would be interesting to examine the impact of SMEs' financial constraints for FDI on their internationalization strategy and their mode of internationalization. Also, it would be useful to find out which variables drive the extent of the FDI constraints faced by SMEs. For instance,

human capital helps firms to successfully execute their internationalization strategy (Hitt, Bierman, Uhlenbruck, and Shimizu 2005); owner education is an important determinant for banks to grant loans to SMEs (Bates 1990). The quality of bank-firm relationships is another major determinant for banks credit decisions: SMEs with more concentrated borrowing and long-term banking relationships have better credit availability, and lower collateral requirements and interest rates (Petersen and Rajan 1994; Berger and Udell 1995; Harhoff and Körting 1998). Firms in an early stage of internationalization have more difficulties in attracting finance for export activities (Bilkey and Tesar 1977). Similarly, it could be expected that first entering an international market presents more severe financing issues. Equivalently, substantial financing constraints are likely for SMEs expanding to dissimilar international markets due to the high costs and risks of managing locational diversity. Next to this, local bank finance deserves further research attention. As shown in this paper, this is in important source of financing for international investments; however, there is a void in the literature on this topic.

This paper must be considered as an explorative inquiry into the extent and the nature of the financial constraints that SMEs face for their FDI projects. Future studies can draw from this research and should deploy alternative and in-depth research methodologies in order to gain a better and more complete understanding of this highly relevant topic.

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TABLE 1

Industry Classification of the Sample

Nace Bel Industry Code	*Nace Bel Industry Description*	*Number of firms in interviewed sample*	*Number of firms in surveyed sample*
01	Agriculture, hunting and related service activities	2	1
15	Manufacture of food products and beverages	5	3
18	Manufacture of wearing apparel/ dressing and dyeing of fur	1	1
22	Publishing, printing and reproduction of recorded media	1	1
25	Manufacture of rubber and plastic products	1	1
28	Manufacture of fabricated metal products, except machinery and equipment	7	6
29	Manufacture of machinery and equipment	4	2
31	Manufacture of electrical machinery and apparatus	1	
32	Manufacture of radio, television and communication equipment and apparatus	2	1
34	Manufacture of motor vehicles, trailers and semi-trailers	2	2
35	Manufacture of other transport equipment	1	1
36	Manufacture of furniture	2	1
45	Construction	2	1
51	Wholesale trade and commission trade, except of motor vehicles and motorcycles	5	2
60	Land transport/ transport via pipelines	1	1
72	Computer and related activities	1	1

This table provides an overview of the industries in which our interviewed (32 SMEs) and surveyed sample (23 SMEs) are active, according to the Nace Bel Industry Code and Description.

TABLE 2

Sample Firm Characteristics

	Mean	***Standard deviation***	***Minimum***	***Median***	***Maximum***
Number of employees					
- *interview sample*	96	137	0	41	700
- *questionnaire sample*	165	208	0	73	700
Total sales (in euro)					
- *interview sample*	13,881,359	13,588,263	100,000	8,480,000	48,458,232
- *questionnaire sample*	22,063,745	24,671,227	185,000	10,900,000	84,000,000
Total assets (in euro)					
- *interview sample*	9,062,853	9,415,279	12,500	4,959,500	32,300,000
- *questionnaire sample*	13,998,976	12,182,480	378,468	12,300,000	37,400,000

This table provides an overview of firm characteristics for our interviewed (32 SMEs) and surveyed sample (23 SMEs). Minimum, mean, median, maximum and standard deviation of the number of employees, total sales and total assets (at end of year 2005) are reported.

TABLE 3

Country of FDI

Country of investment	*Number of firms in interviewed sample*	*Number of firms in surveyed sample*
Egypt	1	
Romania	4	3
Ukraine	1	1
Bulgaria	1	1
Guinea	1	
Slovakia	3	2
China	8	5
USA	1	
Hungary	3	3
Norway	1	1
Portugal	1	1
Russia	1	1
Brasil	1	1
Algeria	1	1
Ghana	1	1
Sri Lanka	1	1
Zambia	1	1
Missing	1	

This table provides an overview of the country of investment of the most recent FDI project for our interviewed (32 SMEs) and surveyed sample (23 SMEs).

TABLE 4

Financing Constraints Faced by SMEs Pursuing FDI: General Overview

To what extent do you agree with the following statements?

(1: totally disagree; 5: totally agree)

Item	***Mean score***	***Significance***	***% score 1 (totally disagree)***	***% score 5 (totally agree)***
- my SME faces financing constraints for its *FDI* projects	3.61	0.040	13.0	30.4
- my SME faces financing constraints for its *domestic* projects	2.26	0.012	34.8	8.7
- financing problems for FDI hinder my SME's growth	3.57	0.050	8.7	34.8
- the FDI financing constraints of my SME are more severe than for				
* my SME's domestic projects	3.77	0.006	4.5	31.8
* large firms	4.00	0.000	4.8	33.3
- my SME sometimes makes use of suboptimal and expensive sources of finance since it cannot attract standard types of financing for its *domestic* projects	1.82	0.000	50.0	4.5
- my SME sometimes makes use of suboptimal and expensive sources of finance since it cannot attract standard types of financing for its *foreign* projects	2.74	0.399	31.8	13.6
- there is a clear failure in the private market to finance SMEs' FDI projects	3.94	0.003	0.0	44.4

This table provides a general overview of the financing constraints faced by SMEs that carry out foreign direct investments, as reported in 23 questionnaires we received. The statements were scored on a 5-point Likert scale, with a score of 1 being equal to “I totally disagree with the statement”, and a score of 5 indicating “I totally agree with the statement”. Mean score is the average score given by the respondents. Significance indicates whether the mean score is statistically significantly different from 3 (p-value from a one sample t-test). % score 1 (totally disagree) represents the percentage of respondents that have marked a 1 score for this statement, while % score 5 (totally agree) shows the percentage of respondents that have marked a 5 score for this statement.

TABLE 5

Internal Financing of FDI Projects

To what extent do you agree with the following statements?

(1: totally disagree; 5: totally agree)

Item	*Mean score*	*Significance*	*% score 1 (totally disagree)*	*% score 5 (totally agree)*
- if my SME would generate insufficient internal funds, it would be very hard to finance the FDI project	3.74	0.008	0.0	39.1
- for financing FDI, my SME is more dependent on internal funds than for domestic projects (with comparable risk)	3.71	0.025	4.8	38.1
- for domestic projects, the cost of external financing is markedly higher than internal financing	3.32	0.268	5.3	15.8
- there is a larger wedge between the cost of external and internal financing for my SME's FDI projects	3.58	0.061	5.3	26.3

This table provides an overview of statements relating to internal financing of FDI projects by the SMEs in our sample, as reported in 23 questionnaires we received. The statements were scored on a 5-point Likert scale, with a score of 1 being equal to “I totally disagree with the statement”, and a score of 5 indicating “I totally agree with the statement”. Mean score is the average score given by the respondents. Significance indicates whether the mean score is statistically significantly different from 3 (p-value from a one sample t-test). % score 1 (totally disagree) represents the percentage of respondents that have marked a 1 score for this statement, while % score 5 (totally agree) shows the percentage of respondents that have marked a 5 score for this statement.

TABLE 6

Impediments to Attracting Local Bank Financing for FDI Projects

To what extent do you agree with the following statements?

(1: totally disagree; 5: totally agree)

Item	***Mean score***	***Significance***	***% score 1 (totally disagree)***	***% score 5 (totally agree)***
- local banks have high collateral requirements	4.16	0.000	5.3	47.4
- local banks charge high interests	4.05	0.000	0.0	42.9
- the amount of the loan is too small	2.30	0.031	35.0	10.0
- my SME has a lack of reputation and contacts in the local bank market	3.00	1.000	15.0	25.0
- local banks refuse to accept domestic guarantees	2.63	0.333	31.3	18.8
- local bank regulation is too restrictive	3.37	0.247	10.5	26.3
- the local bank sector is not well enough developed (for example long term loans and leasing are not offered)	3.26	0.490	21.1	36.8
- my SME is not familiar with local bank regulation	2.81	0.530	23.8	14.3
- obtaining local bank financing is too time consuming	3.61	0.069	5.6	33.3
- there is corruption at local banks	2.11	0.019	55.6	11.1

This table provides an overview of statements relating to local bank financing of FDI projects by the SMEs in our sample, as reported in 23 questionnaires we received. The statements were scored on a 5-point Likert scale, with a score of 1 being equal to “I totally disagree with the statement”, and a score of 5 indicating “I totally agree with the statement”. Mean score is the average score given by the respondents. Significance indicates whether the mean score is statistically significantly different from 3 (p-value from a one sample t-test). % score 1 (totally disagree) represents the percentage of respondents that have marked a 1 score for this statement, while % score 5 (totally agree) shows the percentage of respondents that have marked a 5 score for this statement.

TABLE 7

Impediments to Attracting Domestic Bank Financing for FDI Projects

To what extent do you agree with the following statements?

(1: totally disagree; 5: totally agree)

Item	*Mean score*	*Significance*	*% score 1 (totally disagree)*	*% score 5 (totally agree)*
- the domestic bank refuses to lend to the foreign subsidiary, always lends to domestic parent firm	3.79	0.012	5.3	31.6
- FDI assets cannot serve as collateral	4.22	0.000	0.0	50.0
- FDI assets are very specific and therefore have low collateral value	3.20	0.530	15.0	25.0
- the domestic bank requires domestic assets as collateral, but these have already been collateralized	2.41	0.066	29.4	0.0
- the domestic bank requires (further) personal collateral for the FDI project	3.28	0.531	27.8	50.0
- the limited equity of my SME hinders obtaining FDI bank financing	3.14	0.685	23.8	28.6
- domestic banks are hardly interested in FDI, they have a purely domestic focus	3.32	0.357	10.5	31.6
- domestic banks are reluctant towards FDI due to monitoring issues	3.62	0.044	4.8	38.1
- domestic banks are not equipped to accurately assess the risks of FDI	3.20	0.494	10.0	25.0
- domestic banks only consider lending for acquiring fixed assets, and not for start up costs, market studies, consulting services and business trips required	3.28	0.399	11.1	27.8
- the long lasting search for FDI financing is an obstacle to my SME	3.00	1.000	13.6	22.7
- the long period of time required before a loan request gets approval presents an obstacle to my SME	3.00	1.000	13.6	18.2

This table provides an overview of impediments relating to domestic bank financing of FDI projects by the SMEs in our sample, as reported in 23 questionnaires we received. The impediments were scored on a 5-point Likert scale, with a score of 1 being equal to "I totally disagree with the statement", and a score of 5 indicating "I totally agree with the statement". Mean score is the average score given by the respondents. Significance indicates whether the mean score is statistically significantly different from 3 (p-value from a one sample t-test). % score 1 (totally disagree) represents the percentage of respondents that have marked a 1 score for this statement, while % score 5 (totally agree) shows the percentage of respondents that have marked a 5 score for this statement.

TABLE 8

Attracting Domestic Bank Financing for FDI Projects

To what extent do you agree with the following statements?
(1: totally disagree; 5: totally agree)

Item	*Mean score*	*Significance*	*% score 1 (totally disagree)*	*% score 5 (totally agree)*
- my SME is very dependent on banks for financing domestic and foreign investments	3.65	0.008	4.3	21.7
- if banks judge that the project's risk is too high, they will rather ration credit than raise interest rates	4.24	0.000	0.0	52.4
- on top of interest fees, banks charge other (fixed) costs that are more important for small than for large firms	3.71	0.023	0.0	35.3
- obtaining bank financing for export activities is not a problem at all	2.65	0.251	23.5	5.9
- by raising the SME's equity, FDI bank financing would be facilitated	3.42	0.190	5.3	31.6
- banks have more substantial collateral requirement for small SMEs	4.50	0.000	0.0	60.0
- the stronger my SME's growth, the higher the financing constraints experienced with banks	3.55	0.030	4.5	18.2
- my bank's credit decision for *domestic* projects is based on collateral, and not on the projects' profitability and cash flows	3.45	0.066	4.5	18.2
- my bank's credit decision for *foreign* projects is based on collateral, and not on the projects' profitability and cash flows	3.63	0.048	5.3	36.8
- banks do not question large firms' repayment potential	3.06	0.868	12.5	25.0
- for large firms, banks base their credit decision on the profitability and cash flows of their FDI projects	3.64	0.095	14.3	28.6
- large firms can use FDI assets as collateral for the loan	3.50	0.273	10.0	30.0
- for FDI projects in some specific countries, it is impossible to attract bank financing	4.13	0.003	6.7	53.3
- banks would rather grant a loan for a FDI project				
* in a neighbouring country than in another West-European country	3.93	0.010	6.7	40.0
* in West Europe than in East Europe	3.87	0.011	0.0	37.5
* in East Europe than in Asia	3.42	0.210	0.0	16.7
- obtaining bank financing for FDI				
* in the US is problematic	2.00	0.189	60.0	0.0
* in Africa is problematic	4.25	0.038	12.5	62.5
- my SME sometimes does not ask for bank credit for a valuable though complex FDI project as we know it will not be granted	2.81	0.682	37.5	31.3

This table provides an overview of statements relating to domestic bank financing of FDI projects by the SMEs in our sample, as reported in 23 questionnaires we received. The statements were scored on a 5-point Likert scale, with a score of 1 being equal to “I totally disagree with the statement”, and a score of 5 indicating “I totally agree with the statement”. Mean score is the average score given by the respondents. Significance indicates whether the mean score is statistically significantly different from 3 (p-value from a one sample t-test). % score 1 (totally disagree) represents the percentage of respondents that have marked a 1 score for this statement, while % score 5 (totally agree) shows the percentage of respondents that have marked a 5 score for this statement.

TABLE 9

Factors Domestic Banks Consider in Evaluating Loan Requests for FDI Projects, According to SMEs

To what extent do you agree that domestic banks consider the following factors in evaluating loan requests for FDI projects?

(1: totally disagree; 5: totally agree)

Item	*Mean score*	*Significance*	*% score 1 (totally disagree)*	*% score 5 (totally agree)*
- country of investment, economic and political stability	4.40	0.000	0.0	50.0
- presence of strong currency in local country	4.05	0.000	0.0	30.0
- type of assets to be financed	3.63	0.024	0.0	26.3
- sector of investment	3.81	0.001	0.0	23.8
- realism and feasibility of the FDI's business plan	4.20	0.000	5.0	50.0
- trust and relationship between SME and bank	4.30	0.000	0.0	65.0
- respecting credit limits and minimal solvency level	4.17	0.000	5.6	38.9
- strength of the underlying product	3.29	0.315	14.3	14.3
- sales potential on local market	3.00	1.000	23.8	14.3
- the SME's financial performance	4.33	0.000	0.0	47.6
- management team of the SME	4.00	0.001	9.5	42.9
- presence of the domestic bank in the local country	3.74	0.009	5.3	26.3
- motives behind FDI project	3.55	0.053	10.0	20.0
- risks of the FDI project	4.14	0.000	4.8	52.4
- the SME's ability to pledge collateral	4.65	0.000	0.0	70.0
- raise equity next to debt for the FDI project	4.30	0.000	0.0	50.0
- the SME's experience with FDI	3.53	0.086	5.3	31.6

This table provides an overview of the factors that domestic banks consider in evaluating loan requests for FDI projects, according to SMEs that carry out foreign direct investments, as reported in 23 questionnaires we received. The factors were scored on a 5-point Likert scale, with a score of 1 being equal to “I totally disagree with the statement”, and a score of 5 indicating “I totally agree with the statement”. Mean score is the average score given by the respondents. Significance indicates whether the mean score is statistically significantly different from 3 (p-value from a one sample t-test). % score 1 (totally disagree) represents the percentage of respondents that have marked a 1 score for this statement, while % score 5 (totally agree) shows the percentage of respondents that have marked a 5 score for this statement.

TABLE 10

External Financing of FDI Projects

To what extent do you agree with the following statements?

(1: totally disagree; 5: totally agree)

Item	***Mean score***	***Significance***	***% score 1 (totally disagree)***	***% score 5 (totally agree)***
- raising my SME's equity is hard	3.27	0.229	4.5	9.1
- our current shareholders *cannot* buy new shares	2.67	0.329	33.3	14.3
- our current shareholders *do not want* to buy new shares	2.33	0.016	28.6	4.8
- my SME *cannot* raise equity with new external shareholders	2.90	0.733	15.0	15.0
- my SME *does not want* to raise equity with new external shareholders	3.47	0.187	15.8	36.8
- raise equity with new shareholders is the final financing option that my SME would look for	3.14	0.666	14.3	28.6

This table provides an overview of statements relating to external financing of FDI projects by the SMEs in our sample, as reported in 23 questionnaires we received. The statements were scored on a 5-point Likert scale, with a score of 1 being equal to "I totally disagree with the statement", and a score of 5 indicating "I totally agree with the statement". Mean score is the average score given by the respondents. Significance indicates whether the mean score is statistically significantly different from 3 (p-value from a one sample t-test). % score 1 (totally disagree) represents the percentage of respondents that have marked a 1 score for this statement, while % score 5 (totally agree) shows the percentage of respondents that have marked a 5 score for this statement.

TABLE 11

Impediments to Business Angel Financing of FDI Projects

To what extent do you agree with the following statements?

(1: totally disagree; 5: totally agree)

Item	***Mean score***	***Significance***	***% score 1 (totally disagree)***	***% score 5 (totally agree)***
- my SME *cannot* raise equity with business angels	2.15	0.059	46.2	15.4
- my SME *does not want* to raise equity with business angels	3.19	0.654	25.0	31.3
- my SME is unfamiliar with business angel financing	3.50	0.086	10.0	25.0
- the amount to be financed is too *small* for business angel financing	2.58	0.295	25.0	8.3
- the amount to be financed is too *large* for business angel financing	2.62	0.406	38.5	23.1
- business angel financing is too expensive	3.33	0.371	13.3	26.7
- business angels require too much control and monitoring	3.50	0.135	12.5	18.8

This table provides an overview of impediments relating to business angel financing of FDI projects by the SMEs in our sample, as reported in 23 questionnaires we received. The statements were scored on a 5-point Likert scale, with a score of 1 being equal to “I totally disagree with the statement”, and a score of 5 indicating “I totally agree with the statement”. Mean score is the average score given by the respondents. Significance indicates whether the mean score is statistically significantly different from 3 (p-value from a one sample t-test). % score 1 (totally disagree) represents the percentage of respondents that have marked a 1 score for this statement, while % score 5 (totally agree) shows the percentage of respondents that have marked a 5 score for this statement.

TABLE 12

Impediments to Venture Capital Financing of FDI Projects

To what extent do you agree with the following statements?
(1: totally disagree; 5: totally agree)

Item	***Mean score***	***Significance***	***% score 1 (totally disagree)***	***% score 5 (totally agree)***
- venture capitalists (VCs)				
* are not open to investing in my SME	2.56	0.227	27.8	16.7
* are not open to my SME's FDI projects	2.61	0.310	33.3	16.7
* do not have the skills to accurately assess our *domestic* investment projects	2.06	0.009	41.2	10.5
* do not have the skills to accurately assess our *foreign* investment projects	2.32	0.050	36.8	10.5
* require too much control and monitoring	3.26	0.426	21.1	15.8
* refuse to take minority stakes	2.25	0.018	25.0	6.3
* employ too aggressive investment contracts	3.13	0.751	25.0	18.8
* desire a too quick exit	3.72	0.033	11.1	33.3
* want to pursue a too risky expansion of my SME	2.79	0.583	21.4	21.4
* take too little risk compared to the return they seek	3.60	0.132	13.3	40.0
* may abandon or sell off their stake in case of low performance	3.29	0.452	11.8	41.2
- my SME does not want to be reporting to the VC all the time	3.32	0.391	21.1	31.6
- my SME *cannot* raise equity with a VC	2.20	0.047	40.0	13.3
- my SME *does not want* to raise equity with a VC	3.06	0.891	29.4	35.3
- my SME is unfamiliar with VC financing	2.53	0.203	35.3	11.8
- the amount to be financed is too *small* for VC financing	2.29	0.035	28.6	0.0
- the amount to be financed is too *large* for VC financing	1.64	0.000	50.0	0.0
- VC is too expensive	3.44	0.219	12.5	31.3
- my SME fears to have trouble later buying out the VC	3.83	0.012	5.6	38.9

This table provides an overview of impediments relating to venture capital financing of FDI projects by the SMEs in our sample, as reported in 23 questionnaires we received. The statements were scored on a 5-point Likert scale, with a score of 1 being equal to "I totally disagree with the statement", and a score of 5 indicating "I totally agree with the statement". Mean score is the average score given by the respondents. Significance indicates whether the mean score is statistically significantly different from 3 (p-value from a one sample t-test). % score 1 (totally disagree) represents the percentage of respondents that have marked a 1 score for this statement, while % score 5 (totally agree) shows the percentage of respondents that have marked a 5 score for this statement.

TABLE 13

Venture Capital Financing of FDI Projects

To what extent do you agree with the following statements?
(1: totally disagree; 5: totally agree)

Item	***Mean score***	***Significance***	***% score 1 (totally disagree)***	***% score 5 (totally agree)***
- my SME prefers financing by an industrial partner over VC financing	4.00	0.001	5.0	40.0
- I only consider attracting VC financing when all other financing sources have been exhausted and if it is the only alternative left to finance the FDI project	3.33	0.331	11.1	27.8
- a VC is more interested in an SME that does FDI projects as this boosts potential returns and improves exit opportunities	4.19	0.000	0.0	43.8

This table provides an overview of statements relating to venture capital financing of FDI projects by the SMEs in our sample, as reported in 23 questionnaires we received. The statements were scored on a 5-point Likert scale, with a score of 1 being equal to “I totally disagree with the statement”, and a score of 5 indicating “I totally agree with the statement”. Mean score is the average score given by the respondents. Significance indicates whether the mean score is statistically significantly different from 3 (p-value from a one sample t-test). % score 1 (totally disagree) represents the percentage of respondents that have marked a 1 score for this statement, while % score 5 (totally agree) shows the percentage of respondents that have marked a 5 score for this statement.

TABLE 14

Government Grants for FDI Financing

To what extent do you agree with the following statements?

(1: totally disagree; 5: totally agree)

Item	*Mean score*	*Significance*	*% score 1 (totally disagree)*	*% score 5 (totally agree)*
- financial government support for my SME's FDI projects is most welcome	4.36	0.000	4.5	68.2
- my SME is well informed about the different types of government support for FDI projects	3.43	0.076	4.3	17.4
- the people working at government institutions that provide FDI support are an added value to my international plans	3.19	0.540	14.3	23.8
- it's the government's duty to help resolve the private market's failure to finance SMEs' FDI projects	3.59	0.050	9.1	31.8
- the government should bear part of the SME's FDI project risk	3.27	0.342	9.1	22.7
- the government should guarantee the SME's loan for the FDI project	3.73	0.012	4.5	31.8
- the government needs to respond quickly to requests for FDI support	4.43	0.000	4.8	61.9
- the government must create an environment that facilitates and stimulates international trade (for example information provision, promote domestic firms in foreign countries,..	4.05	0.001	4.8	52.4
- sufficient government support (for example at BCCI) can only be found for large projects and amounts	3.60	0.083	10.0	40.0
- the interest that the BCCI asks for its subordinated debt is too high	3.83	0.005	5.6	27.8
- it is important that the BCCI does not ask for collateral or guarantees	4.05	0.001	5.3	47.4
- obtaining government grants for FDI projects eases access to private financing since				
* it improves my solvency position	3.79	0.012	5.3	36.8
* it provides a good signal (for example to banks)	4.00	0.002	5.3	47.4
- obtaining government grants and support for FDI projects is harder for				
* small SMEs	4.00	0.002	5.6	50.0
* limited amounts required	3.87	0.013	0.0	40.0
* certain industries (for example services)	3.85	0.043	7.7	46.2
- the administrative burden and the efforts required for seeking for government support do not compensate for the benefits obtained	3.14	0.642	19.0	14.3
- without government support, it is very doubtful that some of my FDI projects could be carried forward	2.77	0.528	31.8	27.3

This table provides an overview of statements relating to government grants for FDI projects by the SMEs in our sample, as reported in 23 questionnaires we received. The statements were scored on a 5-point Likert scale, with a score of 1 being equal to “I totally disagree with the statement”, and a score of 5 indicating “I totally agree with the statement”. Mean score is the average score given by the respondents. Significance indicates whether the mean score is statistically significantly different from 3 (p-value from a one sample t-test). % score 1 (totally disagree) represents the percentage of respondents that have marked a 1 score for this statement, while % score 5 (totally agree) shows the percentage of respondents that have marked a 5 score for this statement.

TABLE 15

Domestic partners for FDI projects

To what extent do you agree with the following statements?
(1: totally disagree; 5: totally agree)

Item	***Mean score***	***Significance***	***% score 1 (totally disagree)***	***% score 5 (totally agree)***
- a domestic partner facilitates obtaining				
* domestic financing	3.38	0.209	7.7	7.7
* local financing in the FDI country	2.67	0.394	25.0	8.3
* domestic government support/grants	2.64	0.349	18.2	9.1
* local government support/grants	2.33	0.054	25.0	0.0

This table provides an overview of statements relating to domestic partners for FDI projects by the SMEs in our sample, as reported in 23 questionnaires we received. The statements were scored on a 5-point Likert scale, with a score of 1 being equal to “I totally disagree with the statement”, and a score of 5 indicating “I totally agree with the statement”. Mean score is the average score given by the respondents. Significance indicates whether the mean score is statistically significantly different from 3 (p-value from a one sample t-test). % score 1 (totally disagree) represents the percentage of respondents that have marked a 1 score for this statement, while % score 5 (totally agree) shows the percentage of respondents that have marked a 5 score for this statement.

TABLE 16

Local Partners for FDI Projects

To what extent do you agree with the following statements?

(1: totally disagree; 5: totally agree)

Item	*Mean score*	*Significance*	*% score 1 (totally disagree)*	*% score 5 (totally agree)*
- a local partner facilitates obtaining				
* domestic financing	1.71	0.001	57.1	0.0
* local financing in the FDI country	3.78	0.003	0.0	22.2
* domestic government support/grants	1.69	0.000	46.2	0.0
* local government support/grants	3.83	0.002	5.6	16.7

This table provides an overview of statements relating to local partners for FDI projects by the SMEs in our sample, as reported in 23 questionnaires we received. The statements were scored on a 5-point Likert scale, with a score of 1 being equal to “I totally disagree with the statement”, and a score of 5 indicating “I totally agree with the statement”. Mean score is the average score given by the respondents. Significance indicates whether the mean score is statistically significantly different from 3 (p-value from a one sample t-test). % score 1 (totally disagree) represents the percentage of respondents that have marked a 1 score for this statement, while % score 5 (totally agree) shows the percentage of respondents that have marked a 5 score for this statement.