INCREASING SERVICE EXPORTS: A KEY CONTRIBUTOR IN THE GROWTH OF THE GLOBAL KNOWLEDGE ECONOMY

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Abstract

In a global knowledge economy both business leaders and government policy makers have identified service exports as key outcomes of innovation based strategies and areas in which to achieve sustainable competitive advantage. This Australian based study of service exporters identified key barriers to success and potential role for government agencies. Key findings included misunderstandings over defining service exports, incorrect classifications of exporters, the need for appropriate and timely planning, challenges in obtaining financial support, need for qualified and appropriate human resources, and the need for government incentives and support aimed at increasing innovation and export orientation amongst service exporters.

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INTRODUCTION

In a globally competitive marketplace, many organizations are turning to knowledge management and innovation to gain a competitive advantage. The challenge for government regulators is to identify both industries and organizations with best practice entrepreneurial characteristics to become success models that others can emulate. As knowledge and innovation are key components of the service sector, one would expect service exports to be a leading indicator of government innovation policy success. This paper reviews a government sponsored survey of service exporters to help clarify what risks and barriers they may have to overcome to thrive in a global knowledge economy.

Before developing any strategy to encourage service exports it is important to understand the sector and its potential for innovation leading to international demand. In Australia, an industry innovation survey (IBM-Melbourne Institute, 2007) found that within the service sector some industries had achieved rapid innovation increases over the previous 15 years, such as communication services 68.7%, and finance and insurance 87.9%. However, over the same time period, other service industries achieved very few innovative changes, such as property and business services 4.5%, and cultural and recreational services 12.3%. A recent government study (DITR, 2007) helped identify why these innovation discrepancies exist. These researchers identified skill shortage as a leading deterrent to service based industry innovation. It was also found that larger organisations were the most innovative and less likely to suffer from skill shortages. One the other hand much of the service sector outside of communication, finance and insurance was found to be dominated by small business which lacked the capacity to innovate and had difficulty in attracting the most knowledgeable and innovative job seekers.

Governments at all levels are interested in the development of innovation and competitive industry that leads to export growth. According to Smith (p.6, 2006) exporting “enables government policy makers to enlarge foreign exchange reserves, increase employment levels, improve productivity, and promote societal prosperity”. However it could be argued governments encourage exports for a more fundamental reason: to pay their way in a global economy. According to the Australian Department of Foreign Affairs and Trade (DFAT), the 2006-07 balance of trade deficit was AUD $12 Billion and for the past five years imports have exceeded exports. Although the net trade deficit has been declining each year since it peaked at AUD $22.6 Billion in 2004-05 the subsequent debt needs to be serviced (DFAT, 2007). Service exports based on knowledge management and innovation are seen by many governments as a way to fast-track export growth and in Australia service exports have consistently exceeded service imports growing by 5% in 2007 to $46.2billion (ABS, 2007).

Although a small number of large companies still make the greatest contribution to service export revenues (ABS,2007), smaller companies, which employ less than 100 people, have the potential to grow and become larger companies of the future. The total number of Australian service exporters in 2006-07 was only 2638, making up only 5.95% of all exporters in Australia. This suggests there a great deal of potential for further expansion service export numbers and value considering this is the largest employment sector in the country. Doubling the number of small and medium exporters could boost Australia’s overseas earnings by $8 billion a year (Callick, 2003). While travel and transportation services dominate the service export sector with 73% of total service exports, the fastest growing area by value between 2005-06 and 2006-07 were computer and information services 23.5% and other business services 21.7% (ABS, 2007). The 10.5% growth by value in the previous year for service exports suggests this sector is not only important, but the rapid increase in the major knowledge sections within this sector highlights the importance of knowledge management and
innovation in growing service exports. Past research also suggests government export development policy may need to be targeted at industry level rather than the broad service sector level.

LITERATURE REVIEW

The growth of service exports was covered briefly in the Introduction; a definition, their characteristics, similarities and differences between goods and services exports, challenges they face and the role of government support will be considered in this section. Some of the findings are re-visited in later sections as a result of interviews and the survey conducted for this project.

Defining Service Exports

While service exports are becoming more widely researched a definition of services is still a much-debated issue (Gani and Clemes, 2002). Different authors adopt different definitions, and some authors even change their definition from time to time (Carter, 1984). Although service exports can be understood as service activities that are internationally traded between residents of different countries (Austrade, 1994), the term services covers a heterogeneous range of intangible products and activities that is more difficult to encapsulate within a simple explanation (Department of Economic and Social Affairs, 2002).

Simple definitions of services include “anything that you cannot drop on your foot” (Austrade, 1994) and “generally cannot be held in your hand” (Business Victoria, 2008). In an attempt to gain a better understanding of the concept of services, some authors have divided services into categories (Sacks and Malbon, 1992, Lovelock and Yip, 1996). Current detailed classifications incorporate: transportation, travel, communication, construction, insurance, financial, computer and information, royalties and license fees, other business services, personal cultural and recreational, and government services (Australian Bureau of Statistics, 2007). This method of export service definition is based on the Organization of Economic and Cooperative Development’s (OECD) trade in services classification. It is compatible with Australia’s Balance of Payments statistics, and is compiled in accordance with the latest international standard determined by the International Monetary Fund (Market Information and Analysis Unit, 2002). This definition appears most appropriate and was used as the base for this survey.

The challenges facing exporters

The literature highlights some common challenges to all exporters. This section reviews these challenges and adds specific issues related to service exporters under the headings of planning, finance, resources and role of government.

Planning

When moving into a new market a range of planning issues emerges. Many companies make their decision to export without carefully screening markets, conducting research, considering costs, or weighing alternatives. When early export efforts are unsuccessful because of poor planning, the company can be misled into abandoning exporting altogether (Reif et al., 1997).

According to Sacks and Malbon (1992), before exporting there are trade barriers in the host country to consider. These barriers are many and varied and can be divided into three categories: government monopolies, government regulation, and industry regulation. The literature identified that like goods exporters, service exporters find that trade barriers generally prevent them reaching their full potential. For example, in one Australian study undertaken by the Australia Trade Commission (Austrade), more than one quarter of respondents identified trade barriers, especially product standards and
certification, and 13% cited intellectual property protection as regulatory constraints on their ability to more successfully deliver their services offshore (Austrade, 1994).

State and Federal service export support agencies, (e.g. refer Business Victoria, 2007; DFAT, 2007; and Harcourt, 2002), highlight the need for businesses to consider some basic issues in setting objectives and making the commitment to export. These export support agencies were found to all emphasise that for international success, potential exporters must have the right product or service. Their literature highlighted that the product or service must satisfy the needs of the end user, and be of high quality. They also suggest that firms must have the management capacity to develop and cope with overseas demand. Price, as well as effective implementation of appropriate technology and training linked with an understanding of how to sell the product or service to non-Australian audiences is also identified as important.

Although Yip (2003) noted that exporting services is easier than goods, Reif et al (1997) stated that the decision to export a service is nonetheless, an equally serious one. Like goods exporters, service exporters must do market research to familiarize themselves with the differences in language, culture, and business practices in target markets (Industry Canada, 2003). Businesses that do not prepare adequately may miss opportunities and fail. A common theme of Australian State and Federal export support agencies is to suggest that the success of export activities often depends on the effort put into understanding the target market. Through such a process a firm will be able to examine the driving force of demand of their service (Harcourt, 2002).

Services need to make globally integrated moves as much as product-based companies. But the key feature of such moves, cross-country coordination, can be both easier and more difficult. Coordination can be easier for those services businesses that reproduce a strong core formula around the world. In such businesses, corporate headquarters play a continuing role in monitoring the strategies of overseas units. However, the prevalence of franchising in services, and its concomitant dispersion of ownership, makes global coordination much harder (Yip, 2003).

Difficulties may arise within some firms regarding the maintenance of a high level of commitment (Industry Canada, 2003). Commitment is important for the flexibility in handling foreign clients. It is a combination of willingness to commit time, effort and follow-ups. However, according to Austrade (1994), young companies with less than five years in business often become exporters by accident, through unsolicited external enquiries, rather than because of a strategic plan to expand internationally. This suggests that the businesses may treat exporting more like a sideline than a commitment.

Finance
Lack of capital has been found to be a major barrier preventing non-exporters from exporting (Patterson, 2004). Service exporters usually face problems in securing finance as financial institutions are usually very conservative in their lending policies for service firms. Financial institutions have not developed a high level of sophistication in dealing with service exporters (Austrade, 1994). This situation is compounded by the difficulty in translating assets to access finance, as assets may not be tangible (Parliament of the Commonwealth of Australia, 1996). Lenders insist on borrowers providing, as security, traditional collateral such as inventory and other fixed assets, which includes plant and equipment (Shuman, 2002). Typically, service exporters have nothing to pledge as security other than an assignment of the proceeds of a service (Shuman, 2002). This situation occurs because the most valuable asset a service company has is usually the intelligence and competence of its people, which is not shown in the balance sheets. For smaller firms, which make up the bulk of service exporting firms, asset bases are limited and many are ill prepared to provide the financial information required when they seek finance and equity (Austrade, 1994).
Although exporting opens the doors to new customers, increased turnover, and greater profits, there is always the chance, no matter how much confidence a firm has in its customers, that there will be non-payment problems. Unforeseen political, social, legal and commercial factors can prevent payment to Australian exporters. In the experience of the Australian Export Finance and Insurance Corporation (EFIC), a significant number of non-payments occur even though the firm has enjoyed a long-standing trading relationship with an overseas customer. Often, non-payment is a result of circumstances outside that customer's control. A non-payment can be devastating, especially for small-to medium-sized businesses dependent on cash flow (EFIC, 2003).

According to Austrade, apart from the problem of collateral, many firms seeking finance have been identified as being ill-prepared, poorly organised and in some cases not well administered. Lack of collateral, non-compliance with application criteria, and risks were cited as key reasons why finance was refused (Austrade, 1994). Austrade advises that exporters and financiers need to better understand each other's requirements. In particular, financial institutions need to appreciate the real risks involved in providing finance to service enterprises, and to develop ways to better manage this risk (Austrade, 1994).

**Resources**

As in all businesses, the ability to hire suitable people is a huge challenge. There is a need for the firm to invest in its people, especially for an export business, where the employees must be willing to adapt and cope with an unfamiliar system. According to Kaplan and Rieser (1994), the operation must be supervised directly by quality employees who can maintain high levels of excellence. Fisher and Fisher (1998) added that firms should invest in hiring and developing competent senior export professionals. These authors advise that attracting and retaining good export professionals to deliver excellent services is a major challenge for firms.

According to Austrade (2007), when considering market entry strategies, exporters are often encouraged to replicate a service they have established in Australia. However, it can sometimes mean less control over how the service is delivered. It could leave the service originators open to having their service taken over by local partners, although demonstration of best practice and protection of intellectual property can help reduce this risk.

Similarly, piracy has limited the opportunities for legitimate players in the market. Maintaining pressure to protect intellectual property rights is very important for Australian exporters because of the highly intelligent service component apparent in services export. The extent of this risk is reduced to a limited extent by the Agreement on Trade-Related Aspects of Intellectual Property Rights which helps to promote widespread acceptance of standards and enforcement of regulations (Austrade, 1994).

**Role of government**

Czinkota (2002) noted that there are three basic reasons for government intervention in exporting – overcoming market barriers abroad; bridging market gaps; and alleviating the trade deficit. Essentially Czinkota (2002) sees the role of government as overcoming macroeconomic issues as well as assisting and facilitating organisations handle more immediate concerns. At the strategic level, Australia is pushing most of its major trading partners to open their markets to service industries by lodging a series of proposals seeking the removal of barriers to trade in services (Davis, 2002). This activity has come about since the introduction of the General Agreement on Trade and Services (GATS), which contains fundamental principles including most favoured nation, national treatment, market access and transparency. GATS has helped liberalise international trade in services as it allows organisations to obtain exact information on the regulatory framework of their priority markets. It also gives governments additional opportunities to negotiate the removal or reduction of barriers by targeting restrictions on market access in the financial services, telecommunications, legal services, environmental services and education sectors (Sacks and Malbon, 1992).
Apart from government agencies, Australia has more than 350 associations representing service companies; many are focused on accreditation and maintenance of standards, and have limited resources to assist members in exporting. However, it was noted by Austrade (1994) and confirmed by Coulthard (2003) that the majority of service exporters were unaware of the support schemes, especially those provided by various government agencies.

To assist organisations in Australia, both State and the Federal governments have initiated export support programs through a variety of activities. First, information and advice has been provided via a series of plain English brochures and fact sheets; trade information on the Internet, and a wide range of trade advocacy and outreach activities in both metropolitan and regional Australia. The State and Territory offices of both the Department of Foreign Affairs and Trade and Austrade played a major role in these efforts (DFAT, 2003). Second, government subsidies and incentives have been provided through schemes such as The Export Development Grants Scheme, the Export Facilitation Program and the Export Finance and Insurance Corporation’s financial support scheme. Further direct support is given through the organisation of trade missions and fairs, seminars and workshops. All these activities are aimed at increasing exporters’ revenue, reducing their tax liability, reducing their production and marketing costs and speeding up the process of government approvals.

**METHODOLOGY**

This exploratory study used both qualitative and quantitative methods to ascertain the current situation regarding service exports in the Australian state of Victoria. The study was sponsored by the Department of Innovation, Industry and Regional Development (DIIRD), a Victorian government agency. Following a literature search a questionnaire with a letter of support from DIIRD was sent to approximately 400 businesses. The database for the mail out was derived from a variety of sources, including government agencies, industry associations and local telephone directories. The database search helped identify a broad range of services being exported from Victoria including: education, tourism, engineering consulting, financial services, cultural/ applied art, IT software including games, environmental services including water treatment, legal services, medical services, landscaping architecture, nursing, logistics, serviced apartments, insurance. Only 49 (12.25%) questionnaires were returned. Of these 41 were usable and 8 were not completed. A further 25 questionnaires were returned to sender unopened. This disappointing response was analysed via random telephone contacts and it was found that many firms were reluctant to respond due to concerns about why the government was seeking this information. This response highlighted that researchers must weigh up the consequences in overtly highlighting sponsors, in particular government agencies. Time constraints did not allow a follow-up quantitative survey to be undertaken.

Semi-structured interviews were undertaken with 12 randomly selected Victorian organisations involved in service exports. This approach was considered most appropriate for the study because as noted by Lee (1999, p 62) the researcher is free to pursue matters as the situation dictates. The interviews involved two basic groups working in the service exports area - actual exporters of services, and suppliers of support services to those businesses. The former group included IT, law, business consulting, logistics, events management and project management firms; the latter group included industry organisations, government support agencies and private sector consulting firms. These interviews were taped and transcribed for further analysis and identification of common themes.
RESULTS AND DISCUSSION

Because the questionnaires provided limited responses both in terms of quality and quantity the main focus of this paper is on the qualitative aspects of the research. Some findings from the questionnaire that were noted follow:

**Perceived performance:** When asked how well you believe your service exports had performed against major competitors, seventy four percent of respondents felt their performance was either excellent or above average. When analysed it was found this positive perception on performance was common no matter whether the respondent organisations had large or small service export sales levels, or whether they had few or many employees.

**Use of Government Export support services:** The only thing that was clear from the surveys was that seventy percent of service exporters either did not know or had not bothered to use Government export support services whilst the other thirty percent had used these services only once. Though this might suggest a failure by government export agencies to promote their services or an unwillingness of potential users to seek out financial or advisory services from government agencies, no definitive conclusion can be drawn as only ten organisations responded to this question.

The qualitative results were segmented based on the key themes identified in the literature review. Respondent’s comments and suggestions were analysed and applied to the following topics: service export planning; financing exports; identifying resource requirements and role of government. Before reporting on these factors a brief comment is made on the problem of defining service exports highlighted by this survey.

The Australian Bureau of Statistics (ABS) definition is based on internationally accepted definitions and allows for direct comparison between countries. Or at least that is the idea. Preliminary investigations into the sub-sectors of services suggest that there is widespread confusion regarding how to categorise a range of businesses. As businesses grow they may diversify their activities. The result of this diversity is they might find their operations defined in one of the “other business” categories to the detriment of statistical accuracy and meaningful cross-nation comparison. Given that most people relate to products more easily than to services, which are invisible, developing a meaningful definition is a challenge. It becomes even more so when narrowing the definition down to service exports. This is because people have different connotations as to the meaning of exports versus other activities and often relate exporting to mean the physical transfer of a product to an overseas destination. At the same time they often dismiss the royalty based income they receive from overseas as something other than exporting. The questionnaire found the majority of businesses did not understand that a service could be exported, and none of the respondent manufacturers involved in exporting acknowledged value-added services or at least did not identify them and their monetary value. Whether value-added services are provided is unclear and further investigation will be required to clarify whether manufacturers are taking the opportunity to differentiate themselves from competitors via the use of complementary services. It was noted that a number of organisations incorrectly classified themselves or were incorrectly classified by others as “other exporters” This may result in a range of problems, including insufficient allocation of resources and support by government agencies, poor opportunity matching by service exporters and agencies, and inaccurate data being used in planning for export growth at both State and Federal levels of government.

**Planning**

Developing locally and then expanding globally or going global from the start was a dilemma faced by many organisations. This issue was not clearly answered by respondents though it was acknowledged that some organisations are more likely to gain early access to international markets
than others. In summary, it appears most respondents believed it was best to have developed a successful system at home first, knowing what works and meets local customer requirements before looking to the export market for growth.

Consistent with Harcourt’s (2002) findings, it was emphasised in most interviews that no matter when the decision was made to export, unless the organisation had the resources (in particular financial and human resources), it may fail to take full advantage of international opportunities because it cannot meet the on-going demands of foreign customers. Respondents also emphasised the need to ensure there were enough resources focused on maintaining and growing the domestic market. These respondents felt it was essential to support international development and provide sufficient surplus capital to cover overseas start-up costs.

The importance of developing and maintaining effective networks to build overseas markets through a variety of strategies was emphasised. For example, build on existing contacts – in-country or in Australia; use of government export development bodies, networks, industry associations, banks, private consultants, trade shows. The importance of personal contact was highlighted, through activities such as attending trade shows, local Chamber of Commerce or network meetings, especially when there were guest speakers.

All respondents involved in advising exporters said the choice of which markets to enter required careful planning and market research. The exporters interviewed felt the level of research and planning depended on the proposed market, their past experience and the value of the project itself. Although exporter respondents agreed that the largest market opportunities may be in developed countries with high GDP/GNP, smaller niche markets in developing countries should not be ignored. Some respondents mentioned they had their greatest successes in developing countries where competition was less and the Australian services on offer were significantly more advanced than those offered by local providers. A note of caution was added – choose markets which are open to trade and have in-country incentives to ensure the host country has some stake in ensuring success.

The issue of who should undertake the market research was raised but responses varied from do it yourself to use Austrade recommended providers. Respondents agreed that this research was not a passive undertaking and no matter who assisted in data collection and analysis, the organisation needed to take a proactive interest and overall responsibility for the planning. This was necessary to ensure strategies were in line with the organisation’s growth objectives and all those people involved in developing overseas markets were committed to the process. This finding is consistent with the findings of Reif et al, 1997.

Questions related to the appropriate type of organisational structure for the overseas venture were raised but not really answered. The most common point made was that the structure would depend on what was best for the organisation to achieve its foreign objectives and should take into account its current local operational structure.

Finance

The key issue for all respondents was handling financial transactions, including getting paid. The responses were basically risk-reduction strategies and common to any exporter. They support the findings from the literature review, for example, EFIC (2003). Strategies included: taking out insurance; ensure tight audit clauses are in the contract and it is administered by a local firm; get advances and milestone payments; and/or performance and bid bonds; and hedge for exchange rate variation.
It was noted by most interviewees, and supported by the findings of Austrade (1994), that too often Australian organisations failed to budget correctly for their international expansion. Most suggested that significantly more time would be required in the start-up and on-going phases than planned; the same applied to cost estimations.

Resources

Apart from accessing initial finances respondents identified access to human resources and protection of intellectual property as key resource issues. On a general level, getting access to resources to be competitive was critical to success. Respondents suggested many service exporters were comfortable growing their international business with alliance partners. For example, one respondent involved in large infrastructure projects advised they required a diverse range of skills and therefore for them alliances were common. Though respondents were in favour of growth through alliances, further research is required to identify whether service exporters have a greater attraction to vertical or horizontal alliances, what success level has been achieved and what strategies work best to achieve international success.

Whilst acknowledging there will be competition for experienced staff members a specific issue of public/private competition arose: how do I compete with government enterprises for human resources? There were a number of concerns raised about government involvement in international trade. The main concerns centred on the failure of Australian governments to support local business to the extent provided by foreign governments, such as the Japanese and USA governments, giving their own domestic organisations a priority in bidding for overseas government work. Two respondents suggested that governments should remove themselves from managing major projects and rather than competing for local resources, work with the private sector to win international projects. Other strategies to boost private sector expertise, supported by government involvement, included encouraging the government to build a bigger pool of experts through, for example, an Ambassadors programme, or secondments, where people are encouraged to go overseas to gain experience.

The challenges of working in different cultures was the main human resources issue in all interviews and was a key point emphasised in the survey. Though many respondents raised the concern of language differences and the need to ensure documents were checked for their English translation by at least two different translators, other issues emerged. The most common one related to negotiations. Concerns were expressed that what was said may be different to what was meant, that face saving was important and respecting local cultural nuances would help the relationship develop. Issues such as working with people in other cultures emerged, particularly regarding the need to ensure Australians selected for overseas postings wanted to go and had a support structure for long-term success. Overall, it was generally felt that to be successful in international markets there was a need to understand that the legal, cultural and financial environments were likely to be different to Australia.

In service organisations intellectual property is a fundamental resource; how to protect intellectual property was a key question. Concerns raised were similar to those relating to goods though there was less concern here as it was felt many services adapted to individual project needs. Getting brands and domain names registered in-country was the most favoured strategy. This of course could be different for a licensor or franchisor where developing a quality image and building brand awareness may be their keys to international success. It was not clear from responses whether this latter point was an issue for the selected sample, however, it does need to be further investigated.
Role of government

While Government influence occurs in all of the above areas respondents generally agreed that it was essential for State and Federal Governments, and their agencies, to work closely together in terms of providing support services. Many respondents appeared uncertain as to what services were available for service exporters. Developing more effective communication approaches outlining support and financial assistance packages available to service exporters appears necessary. Respondents were keen to see greater involvement by the Victorian Government in assisting service exporters. However, the only consistent response as to how this should be undertaken was monetary support. The best role for Government to take regarding assisting service exports requires further research. Suggestions for improving assistance to service exporters, based on these results follow in the next section.

CONCLUSION

In view of the issues faced by the exporters, appropriate government support could be of significant benefit in expanding service exports. Support could be provided to assist service export organisations and their customers through:

- Increasing awareness of their services: Government agencies should more aggressively market their services ensuring they target service exporters with appropriate policies and support mechanisms.

- Reducing paperwork and streamlining the approval process: Dealing with bureaucratic processes appeared to be daunting for service exporters interviewed. Many opportunities to enhance the experience of service exporters were identified; including streamlining current large and complex application forms, reducing the number of applicant interviews, and speeding up the approval process by reducing the number of levels of approval required. Service exporters often cannot wait six to twelve months for government approval and receipt of support funding. They are used to responding to their clients in significantly shorter timeframes.

- Education: Government agencies can utilise their own knowledge and consultant network to develop education services appropriate to service exporters. Issues identified as appropriate included finding appropriate and trustworthy partners in overseas markets, protecting intellectual property and ensuring payment for work undertaken. Advice such as that given on the Victorian Government’s website is only useful when potential users can find it or know it exists.

- Networking: Agencies could provide opportunities to match supply and demand. Opportunities include working with industry associations, business angels and business networks.

- Money: Organisations could be reimbursed for appropriate export development costs.

- Risk reduction: Agencies could ensure adequate finance and insurance is available, either directly or indirectly via the private sector.

- Export policies: Policies that encourage and reward new and existing exporters should be developed at both Federal and State level. These policies need to be integrated to overcome potential duplication.
There are several reasons why so little information is known about service exporters. First, it could be due to the fact that agreement has not been reached on a specific definition of services. Second, the difficulties and risks associated with exporting services are not well known. Third, not much is known about how the process of exporting services differs from the process of exporting products. Fourth, little is known about the information needed by service exporters to find overseas markets and deliver services to those markets.

This study highlights the importance of service exports to the global knowledge economy. It also demonstrates that much needs to be done by government agencies if they are to assist current and potential service exporters including the provision of incentives to innovate and export. However, before these policies can be implemented, basic definitions need to be agreed on, data collection improved, cross-country research undertaken and on-going advisory services improved and promoted so awareness of opportunities and support and recognised and accepted in the wider economy. This exploratory study hopefully provides a base for further studies and its limitations in terms of scope and respondents involved need to be recognised when assessing these findings and conclusions drawn.
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