FDI by SMEs in Focus:

A Dubai Case Study

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I. Introduction

1.1 Introduction

> *"Foreign direct investment (FDI) has the potential to generate employment, raise productivity, transfer skills and technology, enhance exports and contribute to the long-term economic development of the world´s developing countries.* ***More than ever, countries at all levels*** *of development seek to leverage FDI for development."*[1] [UNCTAD Website, emphasis added]

The above quote summarizes in an elegant way on what the accent of today's world economy lies; attracting investment from abroad to promote (domestic) economic growth. However, FDI tends to be concentrated in certain areas of the world economy and almost nonexistence in others. Scholars, economists, businessmen, organizations, media and the general public often classify the world *economy* into three groups; (1) the developed/advanced countries, (2) the developing countries and (3) the transition economies[2]. Below the FDI inflows and outflows (excluding reinvested capital/stock) around the globe are given in two separate charts (Chart 1.1 and 1.2 respectively) based on data gathered from UNCTAD FDI database[3];

Chart 1.1

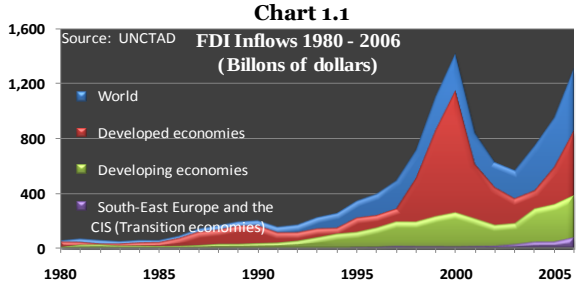
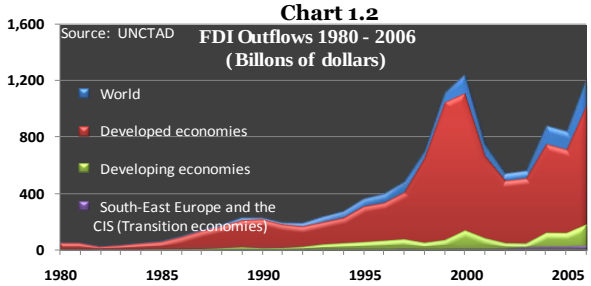


Chart 1.2



As can be observed almost all of the FDI outflows in 1980 – 2006 originate from the developing countries and the developing and transition economies seem to be net receivers of FDI over the same period. Interestingly, the amount of FDI inflows towards the developing countries has been increasing steadily over the years whereas the opposite can be observed with FDI flowing into the developed economies. This latter, among other things, has been subject to great number of research and is thus from a theoretical and empirical point of view considered to be important. This papers aims at contributing to this field of study by focusing on a relative new branch of FDI, namely, FDI by SMEs.

1.2 Research Objectives

As will be discussed in detail in the next chapter of this paper, FDI can occur in many different ways and there are many factors influencing the degree of FDI in a given country/region. This brings us to the part of formulating the research question of this paper, mainly on what specific part of FDI is this paper going to focus at? In the quest of finding substantial information regarding the FDI literature, very little attention was dedicated to small and

[1] Source: http://www.unctad.org/Templates/StartPage.asp?intItemID=2527&lang=1
[2] For a complete list of these countries please refer to Appendix 1
[3] Unless otherwise noted, all of the graphs/charts/figures are prepared by the authors themselves. The sources of data used during the preparation are, where applicable, identified.

medium-sized enterprises (SMEs). Interestingly enough, SMEs have been starting (only recently) to play a crucial role in modern literature. The overall idea nowadays is that small firms could be viewed as possible engines of economic growth. Taking the increasing importance of SMEs in modern economies depicted from various literature (which will be discussed in the next chapter of this paper), and adding it together with the main topic of this paper, FDI, the main research question can be formulated as follows:

*"Which factors do significantly motivate **foreign SMEs** to invest abroad in terms of FDI?"*

The most important element of this research question is *"foreign SMEs".* With this term this paper basically refers to for example, a Dutch SME having invested in Dubai in terms of FDI. One would expect here that the FDI in Dubai will result in a new local SME, however this does not have to be the case (e.g. a joint venture between a Dutch SME and local SME might lead to a larger firm).

To investigate the research question one is required to conduct empirical research. Now, there is a vast amount of literature and research devoted in explaining why certain economies attract more FDI than others. However, these are mainly aimed at certain group of countries (e.g. USA, China, India, new entrants of the EU) leaving certain relatively "small" but interesting countries out of the loop. The question that now arises is how does one go about identifying these interesting economies? It is obviously necessary for these economies to stand out, although not in the same magnitude as China has in recent years. Although not shown here, the total amount of FDI inflow (stocks + inflows) towards Asia has increased dramatically over the years and is mainly contributed to China and India. Excluding these two countries from the continents, two regions seem to stand out in terms of FDI; West-Asia/Middle-East and South-East Asia. From the preliminarily literature research carried out by the authors, a considerable amount was devoted to South-East Asia. Given this lack of existing literature and the personal preferences, background and experience of the authors in the Middle-East, this region has been selected to look at in more detail.

Chart 1.3 below represents the total FDI Inflows (stocks + inflows) per capita per country as a percentage of the total FDI inflow per capita in the entire Middle-East[4]. Two striking observations can be made; (1) The portion of FDI inflows per capita in Bahrain have decreased considerably, from around 60% of the total FDI inflows in 1996 to just above 35% in 2006, and (2) FDI inflows per capita in the United Arab Emirates (UAE) have grown dramatically, from 5% in 1996 to almost 20% in 2006.

Chart 1.3

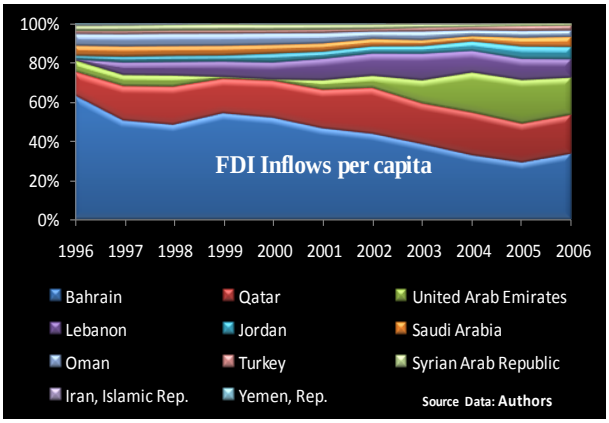
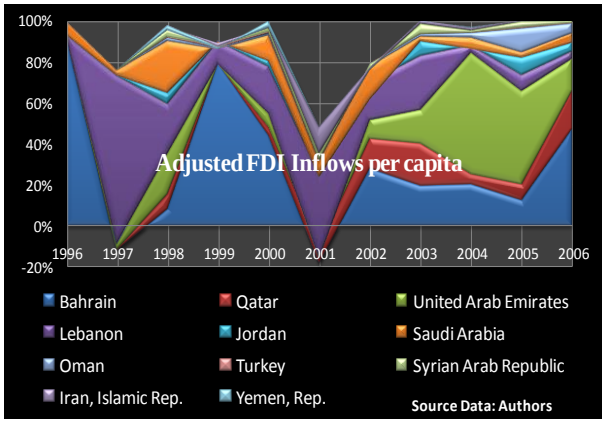


Chart 1.4



[4] Iraq, Kuwait and Palestinian Territory have been excluded due to lack of data.

Arithmetically, the differences over the years can be attributed to either changes in FDI inflow, changes in population growth, or both. In order to depict the real pattern of development of FDI Inflow/Capita, one could adjust the data with a "normaliser"[5] and get the results as depicted in Chart 1.4. Now, the earlier mentioned observations are not to be neglected, as Chart 1.4 clearly shows a changing pattern in the FDI Inflows/Capita for the region by magnifying the real underlying patterns of FDI Inflow/Capita.

In the period 2000 – 2006, the UAE clearly stands out in terms of FDI inflows. There is obviously some kind of development taking place in the region, and the UAE has become more competitive in terms of attracting FDI vis-à-vis its neighbors. Any rational individual would probable ask himself, why has this shift in "balance of power" taken place? Why are firms investing more in the UAE? Maybe the easiest and shortest answer is given by the following quote:

> *"There is no comparison - the activity over here [UAE-Dubai] is far higher and attitude is better."*[6]
> [Kerr, S (2008), "Dubai is the destination of choice"*, The Financial Times,* July 23 2008]

Surprisingly, research on this matter is limited and perhaps the most difficult decision to be made at this point is how to characterize the research as whole. Does one opt for a more general approach in investigating the UAE (e.g. Qasrawi [2004]), or for a more specific one (e.g. Jacobs [2007])? In this paper, the authors have chosen for a focused approach as we firmly believe that investments are generally case specific and one could lose the essence of the underlying relationships by generalizing. The empirical evidence for this view is discussed in great depth and detail in the next chapter.

1.3 Methodology

From the previous section it follows that this paper aims at investigating why FDI (from SMEs in particular) in the UAE has increased rapidly since 1999/2000. The UAE consists of seven emirates (states), namely Abu Dhabi, Ajman, Dubai, Fujairah, Ras al-Khaimah, Sharjah, and Umm al-Quwain. From these emirates, Dubai has been found to be the most suitable candidate for the purpose of this paper. The main reasons for this selection have been Dubai's international character and its reputation in the region as a major destination to do business in. In addition, its economic structure and strategy differs from other emirates in such a way, that one could consider Dubai as being more attractive for foreign small and medium-sized enterprises (SMEs). This is discussed in a greater depth and detail in **chapter 3** (see *3.2 The UAE in more detail* and *3.3 Dubai; History and Development*). The empirical question of this paper will therefore be as follows;

> *"Which factors have significantly motivated foreign SMEs to invest in Dubai in terms of FDI?"*

There is an additional sub-research question that will mainly be used as a benchmark for the empirical findings. This is necessary, because financial statements of SMEs in Dubai are confidential and this limits drawing reliable conclusions concerning the reasons for foreign SMEs to invest in Dubai. This sub-question is as follows:

[5] The FDI Inflows/Per Capita ratios in each year have been multiplied by the corresponding FDI Growth/Population growth ratio of the same year (the "Growth Normaliser") to represent the real pattern of development. For example, if Growth Normaliser = 1 the original data is untouched. If on the other hand, it is >1, the degree of FDI growth has been greater than the growth of population and the corresponding FDI Inflows/Per Capita in *inflated* to present this real pattern. Similarly, FDI Inflows/Per Capita is *deflated* if the Growth Normaliser <1.

[6] Source: http://www.unctad.org/Templates/StartPage.asp?intItemID=2527&lang=1

"To which factor(s) can, if applicable, the current success of SMEs operating in Dubai be contributed to according to the SMEs themselves?"

The importance and relevance of this sub-question will be discussed in chapter 3 of this paper. In order to carry out our empirical research, the following methods will be used:

- *Literature research on FDI and FDI by SMEs*; this will lay out the needed foundation for the empirical research
- *Economic analysis*: data gathered through various resources (e.g. databases) will assist this research in portraying the UAE/Dubai in figures and make, where necessary, assumptions and conclusion possible.
- *Surveys of selected SMEs*; this method will assist us in exploring and examining the factors considered to be of importance for SMEs to invest in Dubai
- *Interview sessions with selected institutions/companies*: interviews serve as a complementary exploration, adding more depth and possible understanding to the results of the surveys.
- *Observations:* by going to Dubai, we are able to witness the daily life there first-hand. Valuable observations may give further insights in interpreting results and drawing conclusions.

1.4 Structure of this paper

Excluding this introduction, this paper consists of three more chapters;

- *Chapter 2: FDI in general and by SMEs in specific*. In this chapter, the factors which explain FDI by SMEs in theory are explained and the theoretical framework (including propositions) of this paper is laid out.
- *Chapter 3*: *Dubai: facts, figures and results.* This part elaborates the rational of selecting Dubai for our case study, the methodology to be used during the research phase and the results of the research carried out for the purpose of answering our research question.
- *Chapter 4*: *Conclusions:* This section will provide the overall conclusion of this paper together with recommendations on future research.

Chapter II:

FDI in general and by SMEs in specific

II. FDI in general and by SMEs in specific

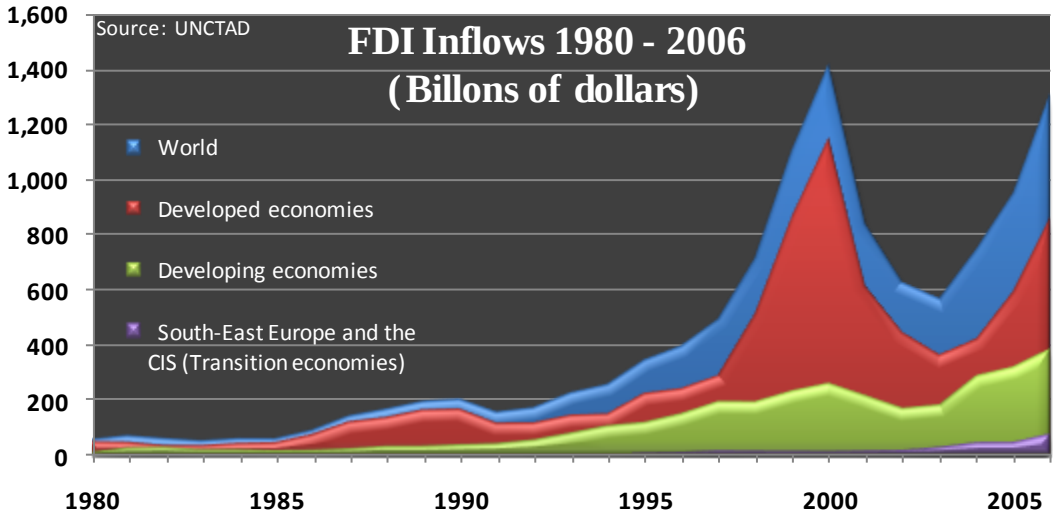
2.1 Introduction

As explained in the introduction, this paper aims at investigating FDI by SMEs. This subject is in essence the combination of two separate studies which both require separate background research. The goal of this chapter is therefore to establish the theoretical framework of this paper by combining existing literature from both fields and layout the required foundation for the rest of this paper.

2.2 Foreign Direct Investment (FDI)

2.2.1 Introduction

As can be seen in the graph 2.1 below, FDI *inflows* around the globe has increased considerably over the years.



Graph 1.1 does not only show the general upward trend of FDI inflows over the years, but it also illustrates the differences between the FDI received per group of economies. Just by these observations, certain fundamental questions arise;

1. What is FDI and what is its importance?
2. What factors influence the degree of FDI received?

This section aims at addressing these questions by using existing literature and findings.

2.2.2 Definition and Significance of FDI

The definition of Foreign Direct Investment (FDI) has evolved over the years. One of the earliest theories of capital movements defined FDI part of portfolio investment (Iversen, 1935; Aliber, 1971). The most important change in definition came from the Hymer's (1960) in which he depicted FDI as "*a means of transferring knowledge and other firm assets, both tangible and tacit, in order to organize production abroad (…) without ownership or Control being relinquished".*[7] More specifically, UNCTAD considers *initial* inflows resulting in 10% stock or asset

ownership *and all the reinvested* earnings of the investor/entity as FDI[8]. It is this latter definition which is being used widely today when referring to FDI, and hence will be adopted in this paper as well. Next to the definition, UNCTAD summarizes the importance of FDI as follows;

"Foreign direct investment (FDI) has the potential to generate employment, raise productivity, transfer skills and technology, enhance exports and contribute to the long-term economic development of the world´s developing countries. More than ever, countries at all levels of development seek to leverage FDI for development."[9]

This statement is naturally derived from the literature, which is briefly discussed below.

FDI and economic growth

A definition of a term is by itself incomplete without proper understanding of its underlying purpose/function. One of the most researched topics with this latter in mind has been the relationship between **FDI and economic growth**. The writings on this issue can be classified into two main streams; one stream analyzes economic growth in which FDI is one of the explanatory factors for output growth (e.g. Borensztein et al. [1998]), while the other investigates FDI as a result of economic growth itself (e.g. Wheeler and Mody [1992]). In other words, the former investigates the impact of FDI *inflows* on the *host* economic growth (**FDI-Led Growth;** KH Zhang [2001]), and the latter the impact of *home* economic growth on the FDI *outflows* (**Growth-Driven FDI**; KH Zhang [2001]). Given the scope of this paper, it is important to view Growth-Led FDI as a reason why firms would consider investing abroad, and Growth-Driven FDI as a reason why countries would like to attract more FDI. For this reason, it is more interesting at this point to discuss the empirical evidence regarding FDI-Led Growth in more detail.

The so-called FDI-Led Growth hypothesis views FDI as a part of the growth driving factors in an economy, such as (domestic) investment, technology, human capital and exports. Recent studies suggest that economic growth can be enhanced through spillover efficiency and technology transfer as result of for example, the managerial expertise and technological know-how brought in by the investing entities (Rodriguez-Clare, [1996]). In addition, increased competition from foreign companies may also force local firms to introduce new technologies ahead of schedule (Blomstrom et al., 1992). One should however, view the possibility of spillover efficiency and technological transfer as being country specific (e.g. heterogeneous; Usha et al. [2001]), depending on host countries' absorptive capability that is largely determined by human capital in host countries (Borensztein et al.,1998).

FDI and employment

One would expect that employment might increase in a country *receiving* FDI, as an increase in economic growth (FDI-Led Growth Hypothesis) is generally – at least according to the classical economic theory (e.g. Edward S. 2007) – associated with a decrease in employment rate (the so-called Okun's Law). However, to understand any relationship between FDI and employment, it is important to understand what attracts FDI to a country. For example, FDI in sectors with relative low labor intensity would have a different effect on employment than FDI in sectors with relative high labor intensity (e.g. Ernst 2005). This implies that FDI has two different but simultaneous effects with regards to employment; (1) importance of FDI itself in terms of magnitude and type (e.g. Greenfield, M&A) and, (2) importance of FDI for the creation of employment in a given sector. This further implies that the link between FDI and employment are country and type specific (heterogeneous). Nevertheless, one could state at this

[7] *Trends in Foreign Direct Investment Flows: A Theoretical and Empirical Analysis* (Sethi et al, 2003)
[8] http://www.unctad.org/Templates/Page.asp?intItemID=3147&lang=1
[9] Source: http://www.unctad.org/Templates/StartPage.asp?intItemID=2527&lang=1

point that FDI has the *potential* to generate employment and that the ultimate outcome depends on more than just the amount of FDI to a country.

FDI and productivity

Another interesting topic with the effects of FDI in mind concerns the possibility of productivity improvements of the domestic firms. This is a theory derived from the modern models of multinational firms which assume that knowledge assets owned by multinationals can be deployed in subsidiaries/establishments outside the parent country (e.g. Carr, MarKusen, & Maskus, [2001]). This theory argues that it is possible that during knowledge transfer from parent companies to their foreign affiliates, some of this owned knowledge can be "spilled over" to domestic firms in the host country through nonmarket transactions (Jonathan et all. [2007]). Unfortunately, the empirical evidence does not lead to a general consensus, as different studies and techniques reveal different results (e.g. Smarzynska [2002]).

2.2.4 Determinants of FDI

There is vast amount of literature published with the aim to determine the underlying factors of FDI movements (out- and inflows). The problem is therefore not in finding these factors, but in classifying and reporting them elegantly. The literature on this matter can, as with the link between FDI and Economic growth, be divided into home and host country determinants; the former outlines the reasons for FDI *outflow* from *home* countries, while the later concerns the underlying motives for FDI *inflows* to *host* countries. Interestingly, there is little literature about the *home country determinants of FDI*. However, given the scope and aim of this paper, both of the groups need to be addressed.

2.2.4.1 Home country determinants of FDI

It is increasingly becoming more difficult to analyze a specific element of today's world economy due to the increasing interdependence and integration (e.g. European Union, USA's recent credit crisis). However, like every story, it must have begun somewhere. In terms of FDI, one would have to start with explaining *how* and *why* a firm has transformed into a multinational corporation. In doing so, one can understand the factors influencing a firm to engage in international activities such as FDI.

How do firms invest abroad?

A good model describing the steps involved in internationalization of firms is the *Uppsala model* (Johanson and Vahlne, [1977]). This model describes the internationalization of firms in four stages (the so-called *establishment chain*):

1. The local firm is primary occupied with selling its goods and services at home, avoiding risks by limiting its involvement in international trade/activities. The firm also lacks the experience of going abroad.
2. Gradually, the firm initiates its international involvement mainly through indirect exporting (e.g. through independent representatives). The country of choice is mainly a country in close proximity to the country of origin in terms of physical distance, cultural differences and business practices.
3. As the size and importance of potential foreign markets increases, the firm may start to increase its involvement abroad by engaging in direct exporting (e.g. through establishment of sales subsidiaries).
4. Depending on factors such as physical distance, trade barriers, costs the firm may opt for acquiring or setting up a manufacturing facilities abroad.

It should be noted here that it is not implied here that all firms will follow all of this stages in turn when becoming international, as firms with different experience and background may skip some stages altogether

The *Uppsala model* has been tested empirically over the years. The empirical evidence supplied with the creation of the model implied that the model holds true in some degree for the four Swedish MNCs: Sandvik, Atlas Copco, Facit, and Volvo (Johanson and Wiedersheim-Paul [1975]). Welch and Luostarinen (1988) published a paper in which they summarized the empirical studies confirming the predictions of the *Uppsala model*. For example, research on FDIs by Japanese firms in South East Asia confirmed the step-wise international commitment of the model (Yoshihara, [1978]). On the other hand, a study of the internationalization of firms in the UK suggests that the model solely holds true for firms without any prior international experience (Millington and Bayliss [1990]).
Having discussed the process of internationalization, one can proceed with discussing the reasons behind the internationalization of the firms (e.g. reasons motivating firms to invest abroad).

Why do firms invest abroad?

As already mentioned, a firm can decide to invest abroad because of underlying forces in its *home* country. The literature on this topic can be broadly divided into two groups: (1) hypotheses and (2) determinant variables. The former explains why firms invest abroad on the basis of factors, arguments and processes (e.g. story-like fashion), whereas the latter attempts to identify variables which could be statistically linked to FDI.

Hypotheses [10]

The hypotheses themselves can be divided into the following groups (Agarwal, [1980]):

- **Hypotheses assuming perfect markets**; these hypotheses are based on the assumption of perfect competition on national factor and/or product markets. They include:
    - *Differential Rate of Return Hypothesis*: this hypothesis states that FDI will flow out of countries with low returns per unit of capital to those with a better outlook, assuming the objective of a firm is to maximize profits. Statistically, there is no conclusive evidence to support this hypothesis.
    - *Portfolio Hypothesis*: this hypothesis proposes that in addition to the rate of return, investors also take into account the **risk** associated with selecting their portfolios (Markowitz [1959], Tobin [1958]). By means of diversifying the underlying securities forming the portfolio across countries, an investor can reduce risk. Although plausible, empirically the hypothesis does not hold. Furthermore, the theory fails to explain why multinational corporations are the main contributors to FDI and why they prefer direct investment to portfolio investment (although some authors (e.g. Ragazzi, [1973]) state that FDI is a substitution for portfolio investment because of the absence of organized markets in developing countries). It also lacks in explaining the differences between industries themselves in the amount of investment abroad.

- **Hypotheses based on market imperfection**: these hypotheses are based on the assumption of imperfect competition on national factor and/or product markets. They include:
    - *Behavioral Hypothesis:* this theory (Aharoni, [1966]) states that there are three factors of fundamental importance during the initial investment decision; uncertainty, information and commitment. Given that managers of a firm have a tendency to overestimate the risk and uncertainty with investments abroad, there must be some initial force pushing the management over this threshold. These forces can be external (e.g. proposals from distributors of the company's products and clients, fear of losing a market, strong competition from abroad in the home market) or internal (e.g. strong interest of top-management). Although plausible, this

[10] This section is heavily derived from the article 'Determinants of Foreign Direct Investment: A Survey' Review of World' by Jamuna Agarwal.

- theory has not lead to a testable empirical hypothesis and the theory was derived from a limited number (38 in total) of US firms.
- *Product Cycle Hypothesis:* This theory, developed by R. Vernon in 1966, attempts to combine both FDI and internationalization of firms. This hypothesis summarizes the life cycle of a product in three stages. In the first stage the product is new and is in its initial phases of its development and production is mainly performed in the home country. This is due to the needed coordination and communication between the R&D and production. During the second stage, the product has matured and exports to foreign developed countries start. Expansion of demand and growing competition inside these foreign markets may attract FDI from the firm. In the third and final stage, the product has become standardized and the exclusivity and innovativeness of the product, which were visible during stage one, have been lost. Price competition forces the firm to invest in developing countries in order to cut costs. Given the fact that the technology, innovation and know-how of the developed countries form the foundations of this theory, the explanatory power of it has weakened over the years. This latter is mainly the cause of weakening position of the developed nations, such as the USA, as being the technological leaders of the world. (Vernon, [1979]).
- *Oligopolistic Hypothesis:* Here, one attempts to explain FDI as a result of **oligopolistic reaction** (Knickerbocker, [1973]). This means that when an oligopolistic firm of a country invests in another country (= host country) through FDI, other oligopolistic firms from the host country may mirror the move to the home country in order to maintain a competitive equilibrium. Flowers [1975] found a significant relationship between the concentration of FDI in the USA and the concentration in the investing countries. Despite the positive empirical support, the theory fails to explain why the initial firm may consider investing abroad.

Before concluding this part, it is important to note that none of the theories mentioned is able to explain all kinds of FDI. To address this issue, Caves (1971) commented that different kinds of explanation are required for different kinds of FDI. This can be done by making a distinguishing between horizontal, vertical and conglomerate investment (done by MNCs). According to him, horizontal investments are concerned with producing similar or similar kind of product abroad as the home country and vertical investment with exploiting raw materials for sake of production at home. Horizontal investment would then occur when firms posses some special asset which would result in higher profits abroad through foreign production (Hymer, [1960]). The key elements here would be the knowledge of how to differentiate the product abroad from imitators and the little cost involved in transferring that knowledge to foreign subsidiaries. As with the vertical investment is concerned, it is likely the result of oligopolistic uncertainty and to create barriers to the entry of new rivals. By having more control over their input requirements, existing firms may raise barriers for likely competitors.

Determinant variables

Besides the hypotheses discussed earlier, many other empirical studies have attempted to identify variables which could be statistically linked to FDI. Central in all of these studies have been the differences between a multinational and a purely national firm, which implies that FDI is mainly performed by multinationals (Agarwal, [1980]). Factors which have turned out to be significant are:

- **Size of the firm**: The rational here is that as a firm grows within a given market, it will reach a certain time when it cannot grow due for example anti-trust regulation or market size (e.g. Horst [1972a], Bergesten et al. [1978]). For the firm to continue to grow, it would have to seek an alternative to further growth at home.

- **R&D expenditure**: This variable is derived from the hypothesis discussed earlier (e.g. Caves, [1971, 1982], Vernon [1966, 1979]) and argues that firms must possess some advantage over the host-country competitors to compensate for the costs of going and doing business abroad. One way of achieving this, is through know-how and technological leadership, all of which can be traced back to R&D expenditure of a firm (Agarwal, [1980]).
- **Foreign trade intensity/Openness of the Economy**: This rational here is that as the trade intensity (beginning with exports and ending with direct investment) increases, the likelihood of trade barriers such as tariffs may force the firm to invest abroad. This relationship has been found to be significant by various studies (e.g Wilkins, [1970, 1974], Rock [1973]). Nowadays this variable is associated with openness of the economy; the liberalization of a country's foreign transactions. However, here the results are mixed (e.g. Kyrkilis 2003).

2.2.4.2 Host country determinants of FDI

In contrast to home country determinants of FDI, the literature concerning the host determinants of FDI (the so-called pull factors) is more extensive and is more aimed at identifying variables which could be linked to FDI inflows empirically. In addition, the underlying techniques and proxies in establishing a link between a variable and the FDI inflows differ greatly. For this reason, no attempt will be made here to encapsulate every single investigated variable. Instead, the focus will be more at identifying and reporting those (group of) determinants which are found to be the most important empirically. This will be done on the basis of the World Investment Report 1998: Trends and Development. A summary of these determinants can be found in figure 2.1 on the next page.

Business/Investment Climate

Logically, a hostile business/investment climate increases the additional costs of doing any business in a foreign country. Factors which influence these costs include; regulatory, bureaucratic, and judicial hurdles; issues of property rights; enforceability of contracts; labor regulations; performance requirements like mandatory joint partnerships and domestic content requirements; and political and macroeconomic stability (Lim, [2001]). One would then expect a negative relationship between hostile business/investment climate and any type of investment.

Empirically however, the results are mixed perhaps due to differences in data, analytical techniques and definitions of variables (Agarwal, [1980], Lim, [2001]). Political risk, approximated by the Conflict and Peace Data Bank, was found to be negatively related to FDI by Nigh and Schollhammer (1987), Nigh (1986) and Lecraw (1991). Economic instability is also found to be negatively associated with FDI by Schneider and Frey (1985) and Apergis and Katrakilidis (1998). The former used high balance of payments deficits and inflation as proxy for economic stability and the latter used inflation and inflation uncertainty. On the other hand, Kobrin (1976) found no relationship between political instability and FDI when using a composite factor (e.g. warfare, riots, general strikes) to approximate political instability. A more recent study with focus on African nations by Asiedu (2006), found that a country with a stable political environment (estimated with assassinations, coups and revolutions) attracts more FDI. Results on other factors are difficult to summarize, as no significant results are reported. However, it is interesting to note that various studies have concluded that free trade zones, special economic zones (SEZs), and export processing zones (EPZs) have a positive effect on FDI as they tend to eliminate hurdles like red tape, regulatory/legal requirements and rigid labor regulations (e.g. Ranis and Schive [1985], Woodward and Rolfe [1993], Fung et al. [2000]).

Figure 2.1 Host Country Determinants of FDI

a. Each of these in turn may be classified by entry mode, for example, Greenfield versus M&A; by degree of foreign ownership (100 percent or joint venture); and by those parts of the value chain of a foreign investor's operations being considered.

Source: Adapted from UNCATD (1998, p.91, Table IV.1)

Trade barriers/openness

Here, it is important to mention that trade barriers/openness have different effects on horizontal and vertical FDI. If Horizontal FDI in a country has been mainly the result of trade barriers, one would expect horizontal FDI to decrease as a result of increased openness. Other type of investment (e.g. other horizontal FDI, vertical FDI) however, would then be expected to increase (Lim, [2001]). The ultimate effect of trade barriers/openness depends apparently on the composition of FDI in a given country.

The empirical research shows as expected mix results, not just because of the composition of FDI, but also because of difficulty in measuring openness. Kravis and Lipsey (1982), Singh and Jun, (1995), Dees (1998) and Lecraw (1991) all found a positive relationship between openness and FDI. They all used indicators like exports or imports to GDP ratios as a proxy to openness. However, Branard (1997) found that higher average tariffs are associated with increasing U.S. FDI and Wheeler and Mody (1992) found no significant relationship when testing the relationship with their own computed index. The index covered import/export restrictions, local content requirements, expropriation risk, currency convertibility, and profit repatriation controls.

Incentives

A country can use incentives to differentiate itself from other countries and thus making it an attractive place for FDI. It is needles to state here that not all incentives affect all types of FDI in the same manner. For example, fiscal incentives may affect FDI which is aimed at minimizing costs, whereas an incentive providing some protection (e.g. limiting competition) may influence horizontal FDI positively. One would expect however, that the overall relationship between incentive and FDI to be positive.

In contrast to the expectations, empirical research shows different results. Reuber *et al.* (1973) concluded that incentives may be of more help for smaller firm with limited experience, but the overall impact on FDI is marginal at its best. They also concluded that incentives generally add to the costs of investment because they are usually accompanied by disincentives (e.g. restrictions on ownership, size, location dividends), so that the positive effect of the incentives is cancelled out by the disincentives. Wheeler and Mody (1992) and Shah (1995) found no significant relationship between tax incentives and FDI, whereas UNCTC (1991) and Woodward and Rolfe (1993) reported that tax incentives have a positive influence on FDI.

Size of the host market

Basic principles of business economics suggest that firms can lower costs through for example, economies of scale and/or scope. The same principles argue that this is only possible when the market size is sufficient large enough to be able to profit from lower fixed costs per unit of output. It is then expected that there should be a positive relationship between market size and horizontal FDI. Vertical FDI should be not influenced by size of the host market, and thus the net effect of market size on FDI should be positive.

As expected, market size (approximated by real GDP or GDP per capita) is found to be significant in many studies (Shatz and Venables, [2000]; Fung et al. [2000]; Dees, [1998]; Branard, [1997]; Wheeler and Mody, [1992]; Kravis and Lipsey, 1982; Reuber et al., 1973). This may imply that most of the global FDI is horizontal in nature (Lim, [2001]).

Economic distance/transport costs

The concept and meaning of distance and time is changing over time mainly due to technological advances (e.g. flying from Washington to Paris takes now considerably less time than it use to take during the beginning of the 19th century). Costs on the other hand, are always of concern for firms deciding to do business abroad. It is

therefore expected that high transport costs would encourage firms exporting to distant countries, to engage in horizontal FDI. Vertical FDI on the other hand, is expected to negatively be associated with transport costs, as shipping of components back to home country would be expensive. How the overall relationship between transports costs and FDI would be is unclear given the heterogeneous elements involved.

Branard (1997) and Dunning (1993) reported a positive relationship between FDI and transport costs, while Elkolm (1998) found the opposite. The former studies covered a mix of developed and developing countries and the latter Swedish multinationals.

Cultural differences/distance

Culture is a complex but important factor in any international business transaction. A famous definition of culture is given by Hofstede (2000) and defines culture according to five dimensions; (1) power distance, (2) individualism, (3) masculinity, (4) uncertainty avoidance, & (5) long-term Orientation[11]. According to Hofstede, cultural differences can influence the way firms operate and conduct business; the greater the proximity between two cultures, the easier it is to conduct business with each other without any additional adjustments. One would then expect that cultural differences are negatively related to FDI, however the ultimate effect would be uncertain given the complexity of culture and the heterogeneous (e.g. different sectors, importance of sectors in an economy, type of FDI) nature of FDI.

The empirical results are, as expected, mixed and surprisingly limited. Dunning (1993) concluded a negative relationship between cultural and geographical distance and FDI. A more recent study by Bhardwaj et al. (2000) concluded a positive relationship between FDI and host countries with lower uncertainty avoidance. On the other hand, Levitt (1983) concluded that the preferences and tastes of consumers in different nations are converging to a global norm. This implies that the effect of cultural differences is likely to decrease over time. Sethi et al. (2003) reported that the cultural distance of developing countries will eventually be ignored in favor of their low-wage advantages.

Factor Costs

In general, the lower the *ex post* costs (e.g. operating costs, production costs) of an investment in a given country, the more attractive it will be for foreign investors. For example, vertical FDI would be expected to be stimulated when production costs in a country are relatively lower than other competing countries. Similarly, horizontal FDI also favors low factor costs and thus would be affected positively with lower factors costs.

The most important and empirically tested factor cost has been labor costs, as the supply of cheap labor in developing countries has been regarded as being one of their main competitive advantages in international trade for certain products (Agarwal, [1980]). Most of empirical researches report a negative statistical link between low labor costs and FDI (e.g. Feenstra and Hanson [1997], Dees [1998]). However, Mody et al. (1998) and Fung et al. (2000) found instead of labor costs, labor quality (proxied by educational achievement) to be significantly positive related to FDI. The former investigated Japanese FDI in Asia and the latter U.S. and Japanese FDI in Chinese provinces.

[11] For a simple overview and further explanation of this definition please refer to http://www.geert-hofstede.com/

Agglomeration effects

As with the concept of economies of scale, it is also expected that firms may benefit from cluster activities (external "economies of scale/scope"). According to Goodall[12], factors contributing to cluster activities can be specified as being *urbanization factor economies* (e.g. population, labor pool and quality of life), *industrialization factor economies* (e.g infrastructure, the degree of industrialization, existing FDI stock) and *localization economies* (e.g. specialized labor pools, technological spillover, vocational training, and political lobbies). It is therefore expected that agglomeration effects have a positive influence on FDI.

Empirical research does indeed give results in line with expectations. Quality of infrastructure, degree of industrialization, and the stock of FDI were found to be significant for FDI by Wheeler and Mody (1992) when analyzing the U.S. manufacturing FDI abroad. More specifically, quality of infrastructure was found to be the most important factor for developing countries, whereas specialized support services were more dominant for industrial economies. In addition, presences of other foreign investors (e.g. existing stocks of FDIs) were also important for foreign investors. Other studies for different countries and industries found similar results; Barry and Bradley (1997) on the computer, instrument engineering, pharmaceutical, and chemical sectors in Ireland; Fung et al. (2000) on the positive influence of infrastructure on FDI in Chinese provinces; Moran (1998); Loree and Guisinger (1995).

2.2.5 Summary

This section has discussed the literature surrounding FDI. More specifically, it has discussed the definition of FDI, its importance for countries and economies, and the underlying forces motivating firms to invest abroad. The next section will continue with FDI, however, the focus is more at discussing FDIs by SMEs around the globe.

[12] Goodall, Brian, Dictionary of Human Geography, Penguin 1987, page 16

2.3 Small and Medium Sized Enterprises (SMEs)

2.3.1 Introduction

"Entrepreneurship has emerged as the engine of economic and social development throughout the world"[13]. It is fair to state that small and medium sized businesses (SMEs) are all created by entrepreneurial commitment. According to various scholars, it has become evident that SMEs play a crucial role in today's global economy. In this section the focus will be to give an explanation as to the motivation behind this occurring trend. First, the definition of small and medium sized businesses will be discussed. This is particularly important as a steppingstone for establishing clear standards in the paper. Following the definition, the importance of SMEs will be explained by addressing the views of existing literature. Furthermore, we address the factors for SMEs to engage in FDI and identify the success factors for SMEs operating abroad.

2.3.2 Definition of SMEs

When defining the SME (small and medium-sized enterprises) sector, considerations have to be made regarding the criteria that can be adopted. The term SME covers a wide range of definitions and measures varying from country to country and varying between the sources reporting SME statistics. At this point a distinction can be made between *qualitative* and *quantitative* descriptions.

Qualitative Descriptions

According to Holmes & Gibson (2001) a number of key qualitative characteristics are typically identified for small firms:

- Management and ownership is not often separated
- Control over business operations and decisions reside with one or two persons, who are usually family members.
- The equity in the business is not publicly traded
- The personal security of the owners is required to secure business debt. Limited Liability is rarely present.
- The level and number of formal contractual relations are kept at a minimum level.
- Personal objectives of owners will guide and directly influence business decisions.

These variables are important as they are often observed in small businesses. The following table (table 2.2.1) gives a brief summary of these qualitative variables.

Table 2.2.1: SME's qualitative descriptions	
Qualitative Descriptions:	**Characteristic(s):**
1. Ownership structure	Not separated, but controlled by same individual(s)
2. Business control	In hands of a limited amount of individual(s) (e.g. family members)
3. Equity	Private, not publicly traded
4. Financial security	Owner(s) are fully accountable for financial losses
5. Contractual relations	Limited, less paperwork needed
6. Business decisions	Based on personal objectives of owner(s)

[13] *Audretsch, D.B. and A.R. Thurik (2004) ' The model of the entrepreneurial economy', International Journal of Entrepreneurship Education, 2 (2), p 144*

When we observe these key qualitative descriptions, the characteristics are by definition difficult to measure as a basis for categorising a group of firms. Moreover, for empirical research, qualitative variables like these as a benchmark are often hard to identify. This has led to most definitions having two parts. First, a qualitative statement of the key characteristics of a small firm and second, a quantitative proxy.

Quantitative Variables

For empirical research studies quantitative variables are preferable. Categorization can be implemented based on the same standards, with lesser ambiguities between variables. A number of quantitative indicators brought forward by economists are profit, invested capital, balance sheet total, earnings, total capital, equity, market position, production and sales volumes, number of employees and turnover (Haake, 1987; Theile, 1996). Some studies use annual sales figures of less than $10 million (Weinstein,1994). However, as suggested by Montazemi (1988), private companies are often reluctant to disclose their annual revenues. This critique is also applicable for the other financial variables just mentioned. In a way, all these financial variables are difficult to attain when conducting research due to the aversion of small businesses towards disclosure of company's sensitive information. Other researchers use the number of employees as discriminatory standard. However, even according to this variable, different thresholds are used. A table (table 2.2.2) with a brief summary of the number of employees as research variable is showed and how these differ among the different authors

Table 2.2.2: Different thresholds used for number of employees variable

Number of Employees regarded as small business	Author(s)
>50	Lai (1994)
>100	Doukidis, Smithson and Lybereas (1994)
>250	Kagan, Lau and Nusgart (1990)
>500	SBA (1990)

In a practical manner, one could state that an employment based proxy has a number of advantages over financial measures of size. The advantages include:

- Number of employees is easily comprehended and quickly visualized (Holmes & Gibson, 2001)
- Financial variables are harder to attain from small-and medium sized companies, than the amount of employees (Montazemi, 1988)
- Over time, financial measures would need to be adjusted for inflation (SBA, 1990)

Common Definition and Applied Variables

The qualitative descriptions and particularly the quantitative measurements described so far are also found to be diverse in several regions and/or countries. A difference in measurement can be observed when we look at the U.S. and the European Union (see Appendix A and B). For this reason, most members of the Organization for Economic Cooperation and Development (OECD) use a three-part classification method for the term small business. The smallest classification scheme for small businesses is called micro-enterprises, while the second class is referred to as small businesses. The final group is regarded as medium-sized businesses. All three categories combined gives the common international term SME (small and medium sized enterprises) or sometimes SMME (small, medium and micro enterprises).

Recognizing the differences in SME descriptions, both qualitative and quantitative and among regions/countries, have forced the OECD adopting an expanded definition:

"SMEs are non-subsidiary, independent firms which employ fewer than a given number of employees. This number varies across countries. The most frequent upper limit designating an SME is 250 employees, as in the European Union. However, some countries set the limit at 200 employees, while the United States considers SMEs to include firms with fewer than 500 employees. Small firms are generally those with fewer than 50 employees, while micro-enterprises have at most ten, or in some cases five, workers. Financial assets are also used to define SMEs. In the European Union , SMEs must have an annual turnover not exceeding EUR 40 million and/or a balance sheet valuation not exceeding EUR 27 million".[14]

2.3.3 Importance of SMEs in today's modern economies

Not too long ago, large companies were regarded as the single driver of economic progress in the economy. Small businesses, from an economical perspective, were viewed as inefficient and nonviable. Therefore it was only a matter of time before they would fade away (Chandler 1977, Galbraith 1967, and Schumpeter 1942). The motivation behind the existence of small businesses was the function of employment and social and political purposes, instead of economic efficiency. This function of small businesses changed more recently into a role ascribed as a vehicle for entrepreneurship contributing in terms of innovative and competitive power, rather than just employment, social and political stability (Morris, 2001). This has been supported further by Audretsch *et al*. (2001); Audretsch *et al*. (2002a); Audretsch and Thurik (2000); Carree and Thurik (1999 and 2003), which suggest that entrepreneurship is one of the determinants of economic growth. These scholars address thereby the fact that small businesses should exist for economic reasons, rather than function as a social good that should be maintained at an economic cost.

Explanations for smallness

As the empirical evidence documenting the re-emergence of small business increased, scholars began to look for explanations and to develop theoretical fundamentals. Carlsson (1992) describes two explanations for the shift toward smallness, particularly in the manufacturing industries. The first explanation deals with the fundamental changes in the world economy from the 1970 are onwards which relate to;

- The intensification of global competition, the increase in the degree of uncertainty and the growth in market fragmentation. The second explanation deals with;

- The introduction of flexible automation which has various effects resulting in a shift from large to smaller firms. The frequency of these changes in the world economy, and in the direction of technological progress, resulted in a structural shift affecting the economies of all industrialized countries.

Also Piore and Sable (1984) argue that the instability of markets in the 1970's resulted in the demise of mass production and promoted flexible specialization. This fundamental change in the path of technological development led to the occurrence of vast diseconomies of scale (level of transaction costs fell dramatically).

The shift away from large firms is not limited to manufacturing industries only. Brock and Evans (1989) confirm the smallness trend across the entire spectrum of the U.S. economy and provide four additional reasons why it has occurred:

[14] *OECD Small and Medium Enterprise Outlook- 2000 Edition, OECD, p.7*

- Increase of labor supply, particularly in the higher education levels, leading to lower real wage
- Changes in consumer tastes (diversification of products and services)
- Relaxation of entry and labor market regulations
- Worldwide economy went through a period of creative destruction

As discussed previously, from a traditional perspective, the widespread assumption was that large enterprises are at the heart of the process of innovation and creation of welfare. This assumption is generally referred to as the *Schumpeterian Hypothesis.* According to Audretsch, Carree, van Stel and Thurik (2001) the countries that have shifted their industry structure towards decentralization in a more rapid way have been rewarded by higher growth rates. Therefore, the focus of attention has shifted towards SMEs and its impact on the economic growth of various countries.

Managed Vs. Entrepreneurial Economy

The change of view in the role of small business is best described in the shift from a *Managed Economy* to an *Entrepreneurial Economy* (Thurik, 2008). Traditional factors (land, labor, capital) do not suffice merely as the sources of competitive advantages. A complementary factor is entrepreneurial capital, or the capacity to engage in entrepreneurial activity. In an 'entrepreneurial'environment, entrepreneurship capital can contribute to growth by injecting (knowledge) diversity and serving as a channel for knowledge spillovers. The argument brought forward is that new (smaller) firms enter the industry by serving as *agents of change* through innovative activity. Entrepreneurship (resulting in business creation) serves in this context as a mechanism by which knowledge spills over to a new firm in which it is commercialized. Recognizing that entrepreneurship helps fostering growth led to the political mandate to promote entrepreneurship. This mandate has already been recognized and discussed by D. Harvey (1989). The reduction of spatial barriers has made competition vital for states and/or local cities across the world. From an urban governance standpoint, an active role is required when fostering entrepreneurial environment and innovative capacity. The task of urban governments becomes more importantly attracting production, financial and consumption flows into its own geographical territory. This can be accomplished by supporting smaller firms, establishing closer links between the public and private sectors and actively promoting local areas to attract new business.

2.3.4 Internationalization of SMEs

Various scholars generally believed that small firms are at a disadvantage when trying to operate in international markets. Small firms are more sensitive to certain failures regarding risks and costs. Accordingly, mainly large firms were empirically proven to be engaged in FDI (Vernon, 1970; Horst, 1972; Caves, 1982). However, due to globalization, the competitive conditions have turned out more international than ever. Because international trade and the number of multinational corporations have expanded so much in the past decades, the number of internationally experienced managers have greatly increased, and so has their international mobility (labor supply restrictions are reduced). In addition, technological change has brought most areas of the world within easy reach of telephones, fax machines, and even computer terminals. These increasing efficiencies have decreased everyone's costs of conducting international business. According to these changes SMEs should be able to enjoy the same advantages multinational corporations once had. The interesting question arises whether SMEs play an important role in FDI as well. So far there is very little known concerning this issue specifically. Limited conclusive material exists regarding the importance or role of SMEs in the FDI arena (Oviatt and McDougall,

1995; Kohn 1997; Fujita, 1997). In an attempt to tackle this interesting matter the authors decided to focus on what factors would trigger SMEs to carry out FDI. Based on these factors one can obtain understanding in the decision-making process of SMEs in particular. At this point we will discuss the factors for SMEs to operate abroad. Taking this into account and trying to find a solid basis for our own research, we move our attention towards an already applied framework. This framework will be introduced as a starting point that identifies the key FDI factors for SMEs. The framework (Appendix C) is based on Kuo, H-C & Li, Y (2003). Understanding the factors in the framework from a theoretical perspective is critical since these factors can vary due to contextual differences. Drawing from the general factors discussed in the previous FDI sections will help us distinguish which factors specifically relate to SMEs. Interestingly for our own paper is investigating the significant factors of SMEs to operate in Dubai. Once the factors are clarified for SMEs, we move to the subsequent section in which the success factors of (international) SMEs are identified.

2.3.4.1 Kuo, H-C & Li's Conceptual Framework

As mentioned earlier, the purpose of our own paper is to investigate the determinants of FDI for international SMEs in Dubai. However, what motivates SMEs to conduct FDI? To answer this question properly, we move to the conceptual framework discussed by Kuo, H-C & Li (2003) (for more information please refer to *Appendix 4: The conceptual framework of the incentives of FDI*). As illustrated from the figure, SMEs are influenced by two factors:

- ***Internal factors***; these factors are firm-specific variables including R&D intensities, firm sizes, capital intensities and export ratios.
- ***External factors***; these factors are external FDI motivators including resource foundation, relationship network, following markets and strategic considerations.

All the economic factors mentioned are hypothesized (H1, H2,….,H8) and discussed in the article according to existing literature. Consequently, all these propositions were empirically tested. The same order will be followed hereunder when explaining the factors. A critical note so far, before addressing the factors. The factors are mentioned according to the article, however, the empirical results are left out as this paper sets out to obtain determinants used by other authors for similar research purposes. We will discuss each factor since these can be examined and re-evaluated for foreign SMEs operating in Dubai.

1. *R&D intensities* are important for firms when engaging in FDI, because firms that are able to be technological leaders have considerable advantages in competing internationally. Fujita (1997) shows that firm sizes are unrelated to innovative activities and stresses the importance of considerable R&D expenditures for realizing continuing product innovations. Acs and Audretsch (1988) find that smaller firms are more successful innovators. Smaller firms are better at creating radical innovations since they are better at holding property rights.

2. As stated earlier, *large firms* are seen as having a greater ability to globalize and conduct FDI. The general view that supports this idea is that larger firms have more resources than smaller ones. Therefore, larger firms are able to absorb more obstacles and failures without seriously harming the existence of the company. In this case FDI positively relates to firm sizes. This is supported by Horst (1972), Wolf (1977), Lall (1980), and Yu & Ito (1988). SMEs that are larger are expected to have greater tendencies to undertake FDI than smaller SMEs.

3. Important advantages of investing in foreign markets are decreasing costs of operation (transportation, market size benefits versus high fixed costs and differentiation benefits). A high level of *export ratios* for SMEs will induce greater propensity towards FDI.

4. Firms that are affected by high level of costs (especially wages, land etc), and also are highly dependable on these, will want to eliminate their weakness by taking advantage of valuable (and cheaper) resources overseas. As in the case for Taiwan's FDI, the main motivation for Taiwanese SMEs to invest abroad was in fact utilizing low-cost labor (Chen, 1992). This was a direct effect due to the increase in wage rates (after 1986) that potentially harmed the labor-intensive firms. Correspondingly, we could state that *high level of capital intensities* may force SMEs to invest abroad, because capital engagement is affected by these changes. Firms are less likely forced looking across borders in search of cheap labor or land.

5. Griffin and Pustay (1996) show that reducing production costs is one of the most important factors for firms when deciding to conduct FDI. These production costs are; materials, land and labor. According to Kuo, H-C & Li's article three variables can be categorized from the production costs consideration. Securing raw-material supply, utilizing local labor and access to cheap lands may intensify a firm's strategic position and are all included to the factor *resource foundation*. Therefore, an increasing motivation of resource foundation will have positive effects on SMEs intention to undertake FDI, as cheaper and better resource acquisitions abroad will pull investments.

6. Another external factor that must be taken into consideration involve *network relationships*. Two variables are drawn from the article and include; a) following major clients and, b) investment with other firms in the same industry. The first variable is referred to as a vertical type of network. The horizontal type of network (second variable) consists of home based firms in a production network that may want to penetrate a foreign market and will choose to do so by investing overseas together with another firm. This will reduce uncertainty and decrease operational risk (Johanson and Mattson, 1987). Therefore, network linkages could be seen as a motivation for SMEs to invest abroad.

7. The third external factor is described as *following markets*. Expanding markets, avoiding trade barriers and collecting market information are three variables that encapsulate the motivation of following markets.

8. Strategic considerations according to Kuo, H-C & Li include variables such as capitalizing on tax incentives and acquiring key or new technologies. Preferential tax arrangements or areas that provide opportunities to acquire key production or management technologies in host countries will attract SMEs foreign commitment.

2.3.4.2 Identifying Factors for FDI

From the conceptual framework, one is able to summarize and identify the (SME) factors for FDI. All the factors and corresponding variables that were discussed by Kuo, H-C & Li can be summarized in the following table (table 2.2.3).

Table 2.2.3: SME Factors for FDI based on the Conceptual Framework

FDI Factors	Variables
Internal Factors:	
• R&D Intensities	***R&D expenditures/sales*** (%)
• Firm Sizes	***Total Assets***
• Export Ratios	***Export Sales/total sales***
• Capital Intensities	***Total capital/number of employees*** (%)
External Factors:	
• Resource Foundation	(Cheap) ***material***, ***labor*** and/or ***land*** acquisition
• Relationship Network	***V-Network degree***; following major clients ***H-Network degree***; investment with other firms in the same industry
• Following Markets	***Market expansion***, ***avoiding trade barriers*** and/or ***collecting market information***
• Strategic Consideration	***Tax***; capitalizing on tax incentives ***Technology***; acquiring key or new technologies

In search of supplementary factors identified by other research papers to engage in FDI, an interesting study was found by UNCTAD in 1998[15], where a slightly different approach was taken when investigating the key determinants for SMEs. The Report is based on case studies and a questionnaire survey conducted in selected developing countries in Asia. The FDI factors derived from the paper are shown in the following table (table 2.2.4).

Table 2.2.4: SME Factors for FDI based on UNCTAD research paper(1998)

FDI Factors	Variables
Push Factors:	
→	Lack of opportunities for growth in home market
→	Lack of access to finance at home
→	Lack of access to technology at home
→	Rising production costs in home market
→	Increased competition in home market
→	Volatility and risk diversification
Pull Factors:	
→	Access to skilled labor
→	Access to management skills
→	Lower costs of production
→	Market growth opportunities in host
→	Market growth opportunities in third countries
→	Tax incentives for foreign investment
→	Access to special materials
→	Overcoming protective restrictions
→	Advantage from local market knowledge
→	Technical or product lead advantages
Managerial Factors:	
→	International experience of managers
→	Information about opportunities abroad
→	Market research
Chance Factors:	
→	Chance Encounters
→	Approached by customer from abroad
→	Approached by partner from abroad
→	Saw opportunity and took it

[15] *UNCTAD, Handbook on Foreign Direct Investment by Small and Medium-sized Enterprises: Lessons from Asia – 1998, United Nations publication, Geneva*

The list of FDI factors mentioned in the table above is much more exhaustive than the factors laid out in table 2.2.3. At a glance, many variables that were subject to investigation for both studies are similar in one way or another. The variables of the internal and external factors discussed in the conceptual framework by Kuo, H-C & Li can be compared to most of the variables discussed by push and pull factors in the table 2.2.4. However, two additional factors and related variables provided by UNCTAD are included, namely *managerial* and *chance* factors. Therefore, both factors can amount to the completeness of SMEs wanting to conduct FDI. Many factors and variables discussed in this paragraph can be applied in the empirical section of this paper, where an investigation is carried out to find the factors which have played a significant role in the investment decisions of SMEs operating in Dubai.

Before proceeding to the methodology section, an additional paragraph is dedicated to the success factors for SMEs. Deciding to go abroad is a critical step for a company, however, going abroad for the pre-set reasons (e.g. determinants) is only side of the coin. The other side encompasses the factors firms regard as being positively accountable to their success in their current operations abroad. In theory, both side of the coins should be correlated in some way, as they describe the same phenomenon from different perspectives and at different stages; empirical (reasons for FDI) and practical (reasons operating abroad). Only by comparing the findings from both sides of the same coin, is one able to draw interesting conclusion regarding the true determinants.

2.3.4.3 Success Factors SMEs Abroad

It is important to note that the aim of this paper is not to re-investigate these success factors, but to use these factors as a comparison when approaching the firms during the implementation phase of the research.

Little is known regarding the success factors in the field of international SMEs. However, in a study by Hall (2004), some findings were shown regarding factors affecting SMEs international activities. Key factors which were found in almost all of the OECD country studied by Hall are:

- Attention to the needs of customers, a willingness to adapt the product to the needs of customers and an attention to quality.
- Management resources, especially management having sufficient time and commitment to devote to internationalization, and having specific skills or knowledge, including languages and cultural awareness.
- International experience of managers, staff and representatives.
- Access to reliable and timely information about markets, opportunities, regulations, available forms of assistance, and the processes of dealing with foreign customers and bureaucracies.
- The absence, reduction, or streamlining of international regulations and trade barriers[16].

Other success factors are also discussed by Cruz-Carreon (2006), where the most important factors of international success for Australian SMEs were studied. In conducting the investigation it was found that the owner/managers interviewed had considerable overseas exposure and viewed the Australian market as limited. Consequently, the respondents had decided at a very early stage of their operations that they would pursue opportunities in

[16] *Skilling for Internationalisation: Findings from OECD Research on the Globalisation of SMEs - p 5,(Hall, 2004)*

international markets. The study further revealed that four SMEs who were part of this study have based their success in international markets primarily on:

1. an innovative product that conforms to global quality and competitive standards and,
2. an intuitive connection with well-defined niche markets.

In addition, the investigations drawing from the multiple data sources indicate that these firms have combined the following elements to achieve continued international success:

- Leveraging on information technology.
- Personal contacts and earning the trust of current and potential clients.
- Planned, systematic approach to their internationalization.
- Customer responsiveness and appropriate Customer Relationship Management systems.
- Use of training for international operations and other forms of government assistance.[17]

From the factors mentioned in both literatures we are able to identify the successive elements for SMEs when operating abroad. To address this matter in similar fashion as in the previous paragraphs when discussing the factors of FDI for SMEs, the same outline will be used. Internal and external factors can be extracted from the factors of success literature. Accordingly, the identification of factors adding to successful operations are presented in the following table (table 2.2.5):

Table 2.2.5: Success factors for International operating SMEs

Internal Successive Factors	External Successive Factors
Innovative Product/Service	Role of Institutions
Niche Market Positioning	Infrastructure
Management Resources	Regulations & Trade Barriers
Customer Care	
Knowledge of Foreign Market	
International Experience	

According to the (limited amount of) literature studies, the previous factors (Table 2.2.5) are considered to play an important role in the success of a firm operating abroad. Recognizing the lack of abundant literature in terms of the success factors for international operating SMEs, and although these factors determine important criteria for attaining success, it is important to consider that these factors are also specific to the business market in which the SME operate. By taking into account the heterogeneous character of economic growth and FDI (see *2.2.2 Definition and Significance of FDI*), one could argue in the same manner that success factors are circumstance specific (e.g. depending on country, environment, sector).

These success factors (although not all) will be, as noted earlier, used during both the research and empirical phase of this paper. During the research phase (data gathering), these factors of success will be used to reflect the view of SMEs as to why they consider Dubai an attractive and successful place to invest in. In the empirical part (data gathering + processing results and deriving conclusions), the factors which have been selected by the firms will be compared with the empirical findings.

[17] SME Internationalization Processes in a Transitioning Entrepreneurial Economy – p 6, (Cruz-Carreon, 2006)

2.3.5 Summary

This section has discussed the literature surrounding SMEs. More specifically, it has discussed the definition of SMEs, its importance in today's modern economies and the FDI and success factors for these firms to operate abroad. The next section will incorporate the findings of the previous section (FDI) and this section in drawing the appropriate research design in order to carry out the research phase. The research plan will be elaborated next in the methodology section.

Chapter III:

Dubai: facts, figures, and results

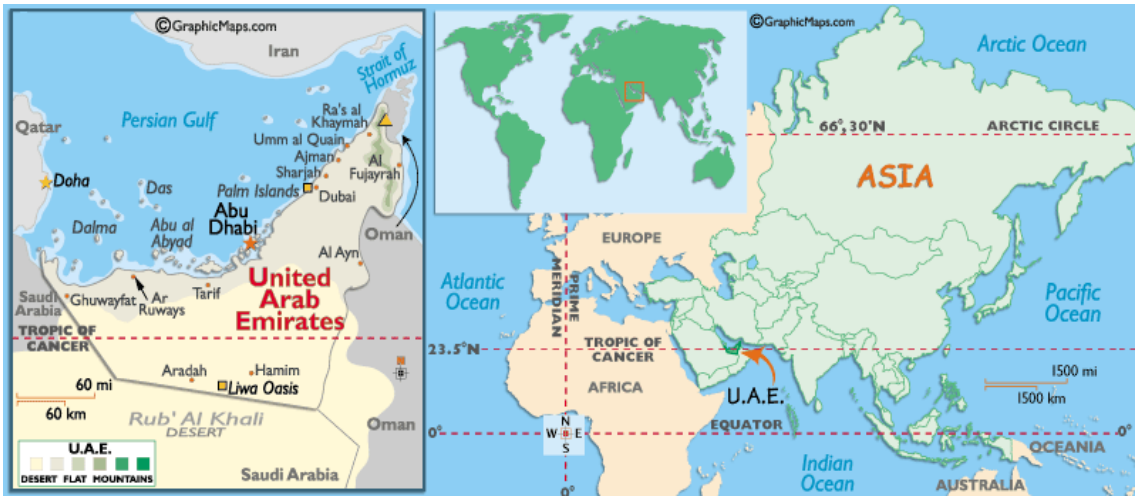
III. Dubai: facts, figures and results

3.1 Introduction

This chapter begins by rationalizing the choice of Dubai as a candidate for our empirical research. In doing so, a macro- to meso-economic analysis is performed. After having justified the selection of Dubai for our case study, we then continue by explaining the sampling procedure and techniques of foreign SMEs in Dubai. For the purpose of the sample selection, Dubai's economy will be analyzed to almost a micro level. The information gathering techniques and procedures are also discussed. This chapter concludes with the presentation of the results.

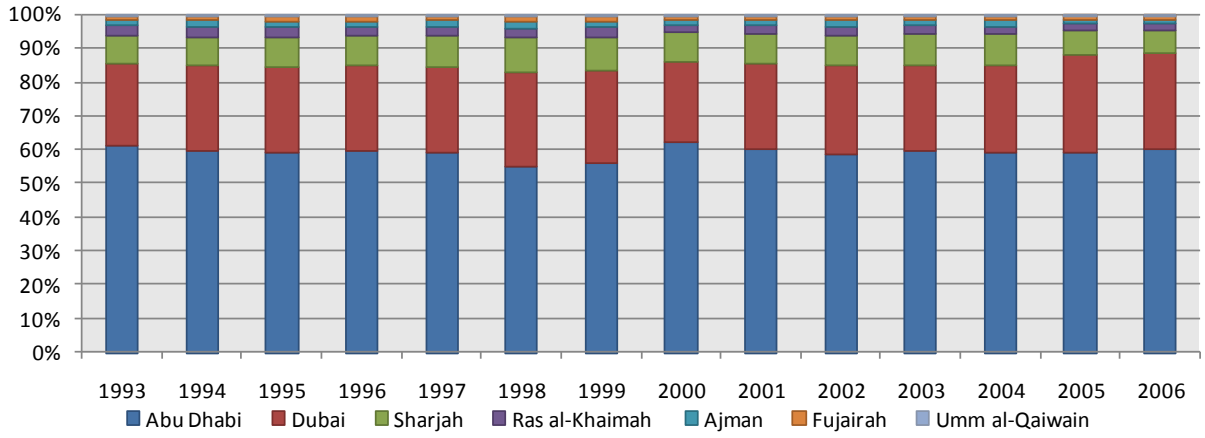
3.2 The UAE in More Detail

In the introduction it was already noted that the UAE consists of seven emirates (states), namely Abu Dhabi, Ajman, Dubai, Fujairah, Ras al-Khaimah, Sharjah, and Umm al-Quwain. The UAE is located in the Middle-East, south of the Persian Gulf (see map below).



According to unofficial and secondary sources (e.g. UAEinteract.com), Abu Dhabi and Dubai account for around 80% of the total FDI inflow in the UAE. In the literature section, it was also mentioned that GDP (in relative terms) is often positively associated to the degree of FDI received by countries (see *2.2.4.2 Host country determinants of FDI*). This relationship between FDI and GDP can also be found by analyzing the GDP distribution by emirate in the UAE in the figure 3.1 below.

Figure III.1 :GDP Distribution by Emirate

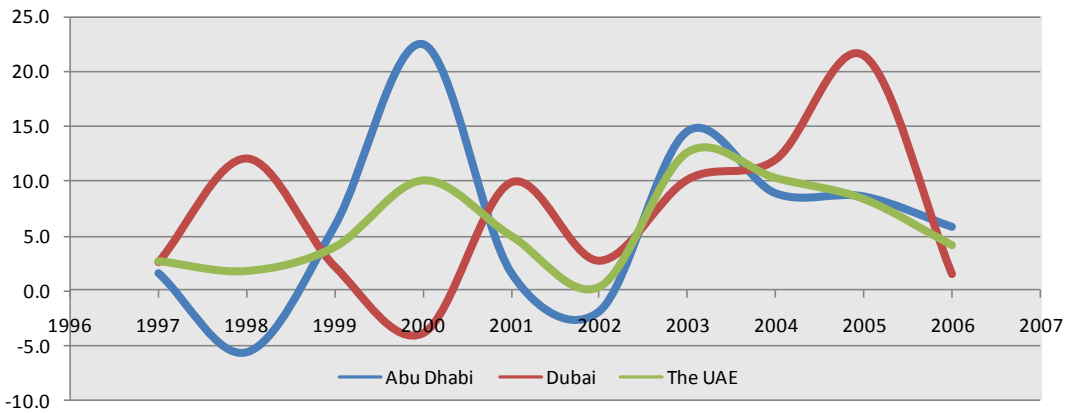


Source: Computed on the basis of Economist Intelligent Country Profile 1997 - 2007

Figure 3.1 shows clearly that Abu Dhabi and Dubai are the major contributors to the total GDP of the UAE and that – by taking into account the wide consensus about the positive relationship between GDP and FDI – the amount of FDI inflows to Abu Dhabi and Dubai according to secondary/unofficial sources can be viewed as reasonable. Given the internationalization of firms as explained by the *Uppsala model* (see *2.2.4.1 Home country determinants of FDI)* and the general view that SMEs are more sensitive to certain failures regarding risks and cost (see *2.3.3 Internationalization of SMEs*), one can at this point infer that the main proportion of FDI by SMEs is plausible to have taken place in Abu Dhabi and/or Dubai.

Having narrowed the focus down to Abu Dhabi and Dubai, it becomes now more interesting to attempt to narrow the research even further given the small but specific population this study aims at investigating; namely foreign SMEs. This focus gives conclusions drawn from the findings more reliability given the underlying differences between the two emirates. Although comparison between the two emirates can be done on many levels (e.g. demographic, political, economic), economic comparison would be more relevant for the purpose and scope of this study. A simple but informative way to start such an analysis would be the comparison of the business cycles (see figure 3.2).

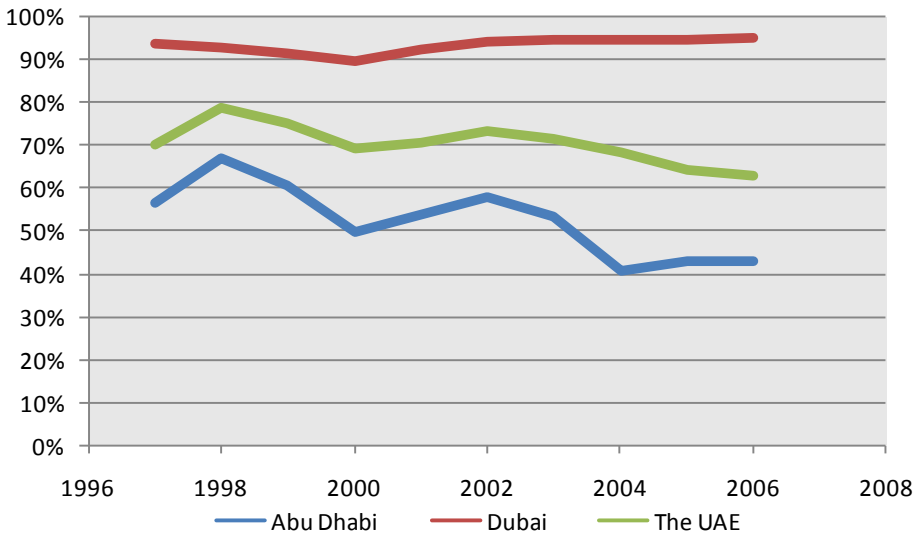
Figure III.2: Real GDP Growth



Source: Computed on the basis of Datamonitor/Marketline, WBI, Euromonitor, Economist Country Profiles, Dubai Statistical Yearbooks, Abu Dhabi Economic Outlook 2007. The GDP deflator of the UAE (Datamonitor) has been used for both emirates.

As can be observed from figure 3.2, Dubai and Abu Dhabi have different business cycles, with Abu Dhabi's business cycle being more coherent with that of the UAE. This coherence between the business cycles of Abu Dhabi and the UAE is not surprising, given that Abu Dhabi accounts for around 60% of the UAE's total GDP. The comparison between the business cycles gives us however, reasons to believe that the economic structure of Dubai is different from that of Abu Dhabi and the Emirates as a whole. The UAE has 9% of the world's proven oil reserves and almost 5% of the world's natural gas (OBG, [2007]), of which 90-95% is located in Abu Dhabi. It is therefore important make a distinction between oil and non-oil components of the GDP. In figure 3.3 the non-oil fraction of the GDP as percentage of the total GDP for the period 1997-2006 is given for Abu Dhabi, Dubai and the UAE.

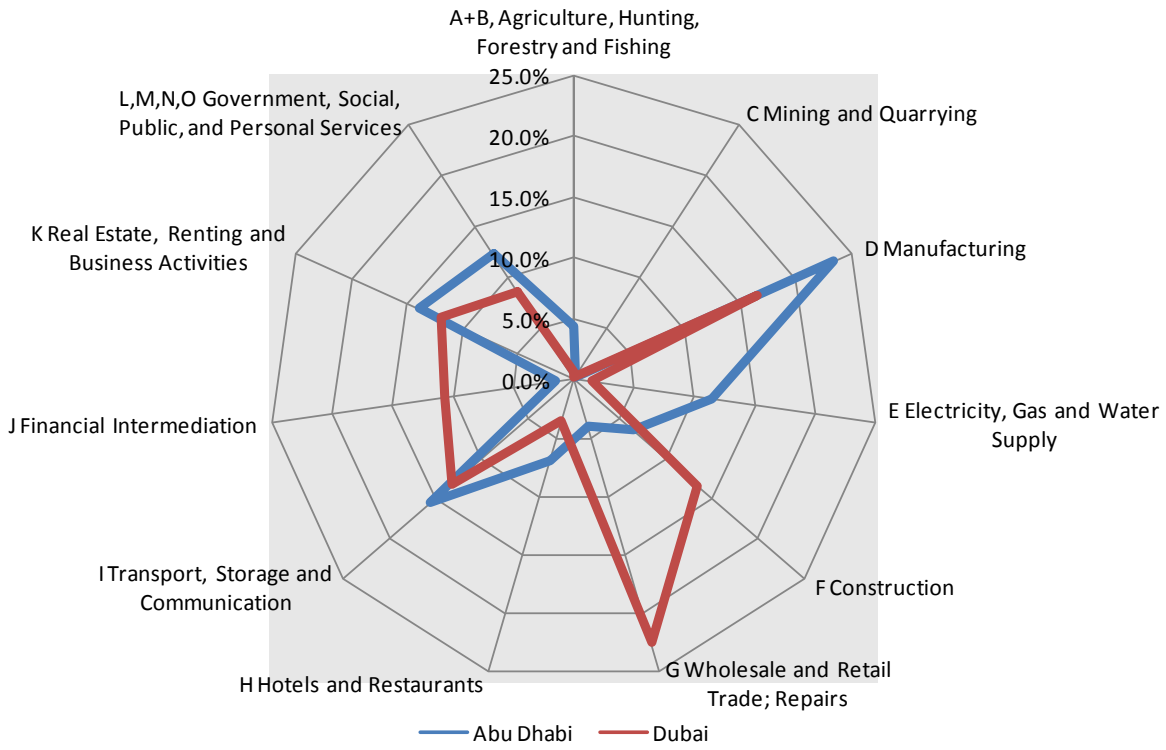
Figure III.3: Non-Oil Fraction of the GDP



Source: Sources: Computed on the basis of Dubai Statistical Yearbooks, Abu Dhabi Economic Indicators, Abud Dhabi Government, Zaywa.com, UAEInteract.com.

Figure 3.3 shows that Dubai's main source of income is from non-oil sectors of the economy (around 95%), whereas the oil sector accounts on average for 50% of Abu Dhabi's total GDP. Now, given the size of Abu Dhabi's economy relative to Dubai and the great difference between the two emirates' oil and non-oil fraction of the economy, a comparison of the non-oil component of the GDP is also necessary. The breakdown of non-oil fractions of the GDP according to Standard Industry Classification (SIC-2003) is presented in figure 3.4

Figure III.4: Breakdown of Non-Oil Fractions of GDP (2006)



Source: Computed on the basis of Dubai Statistical Yearbook 2006, Abu Dhabi Outlook 2007

Figure 3.4 shows the similarities and differences between the non-oil fractions of both emirates' GDP. When focusing on the major differential outliners , one can conclude that Abu Dhabi's income is primary from fractions A+B, D and E; the primary and secondary sectors of the economy. For Dubai on the other hand, the focus is more on the tertiary sector (D, F, G, and J). *The question that now arises is where foreign SMEs are more likely to invest in; in Abu Dhabi or in Dubai?* This question is difficult to answer given the non-existence of direct data on this topic. However, one could make general inferences on the basis of basic economic theory and policy.

Economic Sectors & SMEs

The primary sector (A+B), is unlikely to be attractive for foreign SMEs because of the UAE's harsh climate (low rainfall, high temperatures) and government emphasis on self-sufficiency and control. Moreover, due to the relatively high proportion of UAE nationals in the farming workforce (Economist Country Profile 2007), non-nationals would probably deter from investing in this sector. Electricity, gas and water supply sector (E) is heavily controlled by the government and due to the size and scope of recent and future projects, and given the general accepted characteristics of SMEs (see *2.3.2 Definition of SMEs*), one could consider this sector to be an unattractive segments for foreign SMEs.

The construction sector (F) is undergoing heavy development and growth in both Abu Dhabi and Dubai and the main driver according to various sources is the population growth. Traditionally, construction projects were mainly assigned to big local companies and foreign players (small and big) were left out. However, the boost in growth in the construction sector (started in 2002 with the introduction of the free-hold law in Dubai, and recently enhanced

by population increase programs introduced by Dubai and Abu Dhabi) has overloaded local players. Therefore, this should have been an attractive sector for small foreign developers and contractors to have invested in over the years, especially with the shortage of skilled labor in the UAE's/Dubai's construction sector.

Sector G, - the wholesale and retail trade; repairs – can be considered the most important sector (in terms of GDP) of Dubai's economy. This sector is, according to SIC, divided into sale/trade/repair of motor vehicles and non-motor vehicles (e.g. food, household appliances). In both sub-sectors, one can expect to find SMEs relatively easy mainly because of lack of any practical entry/exit barriers and low capital requirement. By taking into account Dubai's status as the main shopping center, and the current plans for retail space expansions in Dubai (e.g. The Mall of Arabia), this sector can be considered important for foreign SMEs.

Although sector J, Financial Intermediation, is interesting in terms of contribution to Dubai's GDP, it is less interesting for foreign SMEs. This is because of rules and regulation which make foreign entry difficult. For example, the Law specifies that companies engaging in banking, insurance, or financial activities are to be run as public shareholding companies, with a minimum capital requirement of Dh. 2 mil. Furthermore, foreign banks are obliged to paying corporate tax and are officially limited to eight branches in the emirate. The only interesting sub-segment of the Financial Intermediation sector where foreign SMEs could be active is financial intermediation. Firms operating in this sub-segment are treated as any other business unit and are thus not bound to the strict law and regulation governing firms involved in banking, insurance, or financial activities.

On the basis of the preceding analysis, one could safely assume that foreign SMEs are more likely to have settled in Dubai than in Abu Dhabi. For this reason, Dubai has been selected for this study.

3.3 Dubai; History and Development

As can be concluded from the previous section, Dubai's economy differs fundamentally from Abu Dhabi's/The Emirates' in terms of structure. According to Oxford Business Group (OBG), Dubai has consistently been the regional leader in almost all non-oil sectors, which in 2006 contributed to around 95% of Dubai's GDP (see figure 3.3). Obviously, this phenomenon has not come to existence overnight. Indeed, economic diversification has been the center of Dubai's policies for the last 30 years, starting first with infrastructure – ports, airports and logistics – in the 1970s and 1980s, and moving on to trade, manufacturing, construction and real estate, finance, tourism and others[18].

Early History

Records date the birth of modern Dubai back to the beginning of the 19th century, when members of the Al Bu Falasa family migrated from Abu Dhabi to settle somewhere between Sharjah and Abu Dhabi. In the late 18th century, following a series of attacks on their ships in the southern Gulf, the British signed a series of treaties with the various coastal tribes in the region. The end of piracy (whether directly or indirectly) marked a new period for Dubai's economy. At that time, pear fishing had become the main source of income and Dubai had established itself as an integrated part of the British trade routes. However, during the 1930s pearl fishing became less lucrative for Dubai as the result of the great depression and the introduction of cultured pearl by the Japanese. Oil

[18] Derived from *Ramos (2008)*, and the *OBG (2007)*

exploration concessions, gold (especially for merchants), and relaxations of regulations become the new drivers for Dubai's economic growth. In addition, Dubai port's importance as an international trade center was growing.

Oil exploration, Importance and Economic Growth

The British were unsuccessful in exploiting their oil concession rights from 1930s to late 1950s, and abandoned them altogether after that period. The Dubai Petroleum Company on the other hand, found oil fields in mid 1960s and began exporting oil shortly after. During the same period, private and foreign (Britan, Kuwait and Oman) investments/loans – mainly meant for oil exploration purposes – aided in the development of Dubai's infrastructure. As the result of economic growth and investment, Dubai's first Master Plan was constructed in 1959. This plan was developed by the British architect J.R. Harris and outlined the development of basic road structure and infrastructure needed for oil exploration and the growing construction sector. This Master Plan together with the land law - determining how land throughout Dubai could be registered, regulated and transferred – in 1960 laid out the foundations for further economic growth and development throughout the 1960s.

The 1970s and Diversification

With the British withdrawal of their interest in the Gulf, and the increase of world-wide oil prices the seven independent sheikhdoms federated into the United Arab Emirates in 1971. It was during this period however, that Dubai departed from the economic strategy based on oil and gas production practiced by its neighbors. It aimed at industrial diversification, which perhaps can be attributed to the city's historic trade vocation (Ramos, [2008]). The funds for this diversification process were gathered from the oil revenues and invested in large-scale cluster investments (e.g. Jebel Ali project).

The 1980s - Onward

The over-capacity created during the 70s and the oil-crisis lead to economic slowdown. However, the regional conflict (the Iranian revolution and the Iran-Iraq war) strengthened Dubai as an international hub for trade and re-export. During the 1990s Dubai's economy recovered together with the world economy and the importance of Jebel Ali Port was increasing. In 2001, Jebel Ali and Port Rashid merged under a new name - Ports, Customs and Free Zone Corporation and became the region leading port.

3.4 Sampling Procedure & Techniques

Having rationalized the choice of Dubai, one can now proceed with the sampling procedure of foreign SMEs. Ideally, one would draw a representative sample from all the foreign SMEs having invested in Dubai. However, given the non-existence of these data, one would have to approximate this sample by other means. Obviously, aiming at investigating all foreign SMEs would be impracticable and therefore further focus is necessary. This sub-section will address these issues in more detail.

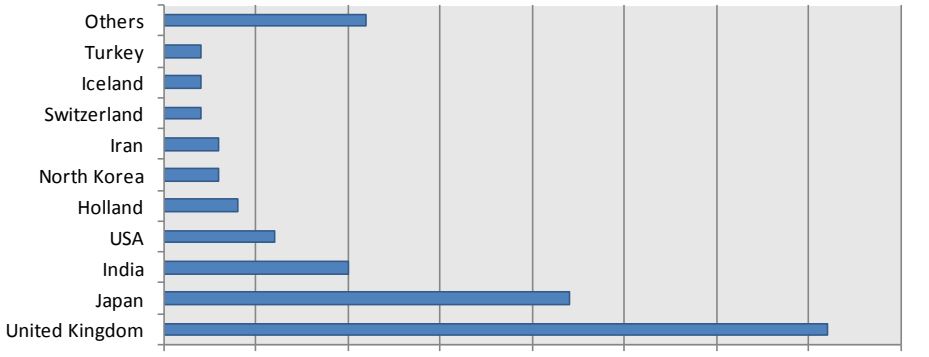
Definition of Foreign SMEs

As already mentioned during the introduction of this paper, *foreign SMEs* refer to foreign companies which can be characterized as SMEs in their country of origin (home country). In this paper, *SMEs* is defined as companies with fewer than 250 employees. Thus, foreign SMEs can be defined as foreign companies with fewer than 250 employees in their home country.

Choice of Home Countries

The choice of SMEs' country of origin will be decided on the basis of the total amount of FDI received by countries. Although it would be dangerous to correlate the total amount of FDI received by a country with the total amount of FDI by SMEs from the same country, one could justify this in relative terms. The rational would then be that SMEs are more likely to invest in a particular country where other (bigger) firms have invested in. (see *2.2.4.1 Home country determinants of FDI,* and *2.3.4 Internationalization of SMEs*). Now, according to Dubai Statistics Center, the FDI in Dubai in 2006 by country was as shown in figure 3.5. As can be observed, the main investors are from the developed countries – the UK, Japan, USA, and Holland – followed by the developing countries – India, North Korea and Iran. From the developed countries, Japan has to be excluded due to its heavy investments in the energy and the public sector (e.g. infrastructure). North Korea has to be excluded as well, as the investments are mainly made by the respective government. This narrows the focus down to the following countries; UK, India, USA, Holland and Iran.

Figure III.5 FDI in Dubai by Country (2006)



Source: Dubai Statistics Center

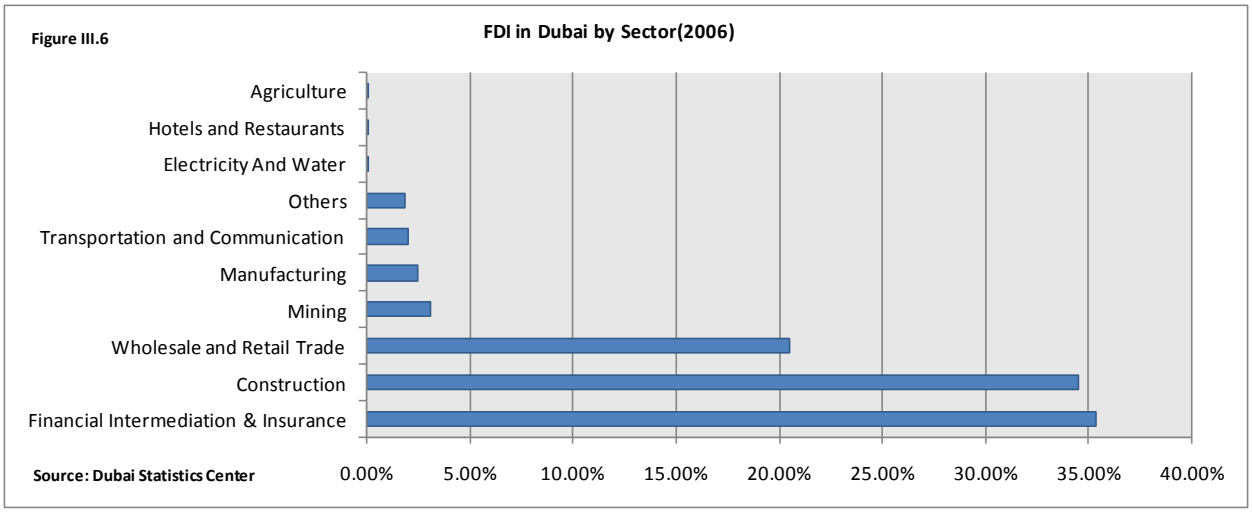
After further analysis of the economic and business structures of the five remaining countries, the authors have decided to exclude India and Iran as well. One of the main reasons for this decision has been the methodological difficulties involved in approaching companies originating from these countries. In both India and Iran for example, the economy is mainly driven by micro-companies (fewer than 10 employees) and would therefore fall outside the

scope of this paper. Furthermore, we expect a high non-response rate from companies originating from these countries, due to political (mainly Iran) and academic background (mainly India). The latter refers to the difficulty involved in finding the right personnel with adequate understanding of the business for the answering of the questionnaire.

Choice of Economic Sectors

The economic sectors considered to be feasible for SMEs to invest in were discussed in detail in *3.4 Sampling Procedure & Techniques*. Interestingly, the conclusions made there seem to correspond to the breakdown of FDI in Dubai by sector in 2006 (see figure 3.6). Therefore, the **main** sectors of interest could be considered to be Construction (F), Wholesale and Retail Trade (G), and Manufacturing (D). However, the other segments of the economy with the exclusion of public sector and the financial intermediation and insurance sector, could be equally important as well. This latter will become clear in the upcoming sub-sections.

Figure III.6



Dataset Creation & Population Selection

Given the fact that there is no readily information about foreign SMEs in Dubai available, the required data has to be created by other means. The authors have constructed the required dataset from enquiries made with the Dubai Chamber of Commerce and Industry regarding companies in Dubai originating from the UK, Holland and USA. From those companies, only active companies meeting the following criteria were selected;

- Companies with license expiry date from 2007 onwards, to take into account any delays at the Dubai Chamber of Commerce regarding license renewal
- Companies with a valid or given registration date
- Companies with a valid name and recorder paid up capital.

It should be noted here that the legal form of all the companies appearing in the dataset is Limited Liability Companies (LLCs). This is because from all the possible legal forms in Dubai, LLCs are the most suitable and appropriate form for foreign SMEs to opt for when investing in Dubai in terms of financing requirement. As a final step, and for comparison reasons, the sectors the companies are operating in were rearranged according to Standard Industry Classification up to 2 digits (SIC-1 & SIC-2). In table 3.1 a selected overview of this dataset is given (the brown marked rows represent the main segments [SIC-1] and the red marked rows represent the biggest sub-segments [SIC-2]). As can be observed from table 3.1, the distribution of firms in Dubai among sectors

for firms originating from Holland, UK and USA is very similar. Also, the selected sectors represent the main sectors in which almost all of the firms are operating. The question that now arises is whether any findings from the Dutch SMEs would be representative for SMEs originating from the UK and USA and vice-versa.

Table 3.1 Companies in Dubai by Origin as a Percentage of Total (April 2008)			
Economic Sector (SIC-1& SIC-2)	**NL**	**UK**	**USA**
D Manufacturing	**13.9%**	**7.0%**	**8.1%**
F Construction	**10.1%**	**10.6%**	**9.5%**
G Wholesale and Retail Trade; Repairs	**61.4%**	**62.2%**	**64.3%**
50 Sale, maintenance and repair of motor vehicles; retail sale of automotive fuel	1.3%	1.8%	1.8%
51 Wholesale trade and commission trade, except of motor vehicles	33.5%	33.4%	32.4%
52 Retail trade, except of motor vehicles; repair of personal and household goods	26.6%	27.1%	30.1%
I Transport, Storage and Communication	**7.6%**	**5.9%**	**8.6%**
60 Land transport; transport via pipelines	1.9%	1.1%	0.9%
61 Water transport	0.0%	0.2%	0.5%
62 Air transport	0.0%	0.1%	0.0%
63 Supporting and auxiliary transport activities; activities of travel agencies	5.1%	4.5%	7.2%
64 Post and telecommunications	0.6%	0.1%	0.0%
K Real Estate, Renting and Business Activities	**5.1%**	**9.5%**	**6.1%**
70 Real estate activities	0.0%	0.3%	0.0%
71 Renting of equipment without operator and of personal and household goods	0.0%	1.1%	1.1%
72 Computer and related activities	0.6%	0.9%	1.6%
73 Research and development	0.0%	0.0%	0.0%
74 Other business activities	4.4%	7.2%	3.4%
Total	**98.1%**	**95.2%**	**96.6%**
Total in Numbers	**155**	**1,378**	**427**
Source: Compiled on the basis of data provided by Dubai Chamber of Commerce and Industry			

One could answer this question in many ways, and a cross-country economic and political comparison would be a required part of any answer. However, given the scope and nature of this paper, one could isolate the analysis only to a simple cross-country analysis of the distribution of SMEs among the economic sectors. The result of this cross-country analysis is represented in table 3.2 (the grey marked row represent segments considered to be important only to the local economy, the brown marked rows represent the main segments [SIC-1] and the red marked rows represent the biggest sub-segments [SIC-2]). Table 3.2 shows broadly the same pattern of distribution as table 3.1, and more importantly, the same pattern among the three countries. One could then *cautiously* assume that findings from SMEs in any one of these countries are representative for the other two countries. The authors have, therefore decided to focus primary on the Dutch SMEs and generalize the findings to SMEs from UK and USA.

Table 3.2 Breakdown of SMEs in Home Economy by Sector (2007 – 2008)			
Economic Sector (SIC-1& SIC-2)	**NL**	**UK**	**USA**
A Agriculture, Hunting and Forestry	**11.6%**	**5.3%**	**1.6%**
B Fishery	**0.1%**	**0.1%**	**0.3%**
C Mining and Quarrying	**0.0%**	**0.1%**	**0.6%**
D Manufacturing	**5.9%**	**8.7%**	**9.2%**
E Electricity, Gas and Water Supply	**0.1%**	**0.0%**	**0.2%**
F Construction	**12.2%**	**11.8%**	**8.7%**
G Wholesale and Retail Trade; Repairs	**20.6%**	**20.4%**	**22.2%**
50 Sale, maintenance and repair of motor vehicles; retail sale of automotive fuel	3.1%	3.8%	6.6%
51 Wholesale trade and commission trade, except of motor vehicles	7.5%	5.6%	4.4%
52 Retail trade, except of motor vehicles; repair of personal and household goods	10.0%	10.9%	11.2%
H Hotels and Restaurants	**4.6%**	**9.6%**	**8.1%**
I Transport, Storage and Communication	**3.6%**	**3.8%**	**4.3%**
60 Land transport; transport via pipelines	1.7%	2.1%	1.9%
61 Water transport	0.5%	0.1%	0.0%
62 Air transport	0.0%	0.0%	0.1%
63 Supporting and auxiliary transport activities; activities of travel agencies	0.8%	0.9%	1.3%
64 Post and telecommunications	0.5%	0.6%	1.0%
J Financial Intermediation	**2.1%**	**1.6%**	**6.9%**
K Real Estate, Renting and Business Activities	**24.9%**	**25.6%**	**18.4%**
70 Real estate activities	2.7%	4.5%	4.4%
71 Renting of equipment without operator and of personal and household goods	0.6%	0.8%	0.9%
72 Computer and related activities	3.0%	3.6%	1.8%
73 Research and development	0.3%	0.2%	0.2%
74 Other business activities	18.3%	16.6%	11.1%
L Public Administration, Defence and Compulsory Social Security	**0.0%**	**0.0%**	**0.1%**
M Education	**2.2%**	**1.2%**	**0.8%**
N Health and Social Work	**5.7%**	**4.4%**	**10.4%**
O Other Community, Social and Personal Service Activities	**6.5%**	**7.6%**	**8.3%**
Total	**100.0%**	**100.0%**	**100.0%**
Source: Compiled on the basis of data provided from CBS (NL) BERR(UK), US Census Bureau (USA). The data from US Census Bureau was converted from NAICS to SIC.			

Sample Selection

Given the relative small population to draw from, namely 155 companies with a Dutch origin (see table 3.1), the entire Dutch population has been selected. From these 155 companies, only 51 were suitable candidates for the goal of this paper. The other 104 were excluded due to one or a combination of the following reasons:

- The firm did not meet the criteria of a SME (e.g. had more than 250 employees)
- The firm was a Multinational Corporation (MNC)
- Contact details were nowhere to be found.

Information Gathering Techniques & Procedures

The field research will be twofold:

a) *Questionnaire.* The list of 51 candidates will be further examined by telephone/email whether they meet the specific requirements regarding size and origin. According to the sample selection, 51 suitable companies were selected out of the original 155 Dutch companies based in Dubai. This was done by screening the companies listed through the Internet. Using the basic information thereof we approach the 51 remaining companies, verify their size and origin, and inquire whether they will fill in the

b) questionnaire. The questionnaire will be distributed through the electronic channel (email). However, approaching (some of the) companies in Dubai for the questionnaire remains a possibility.

The questionnaire serves to explore and examine the factors for Dutch SMEs to invest in Dubai. Five questions are composed in the questionnaire to assess the degree of importance for the specific businesses to invest and operate in Dubai (for more information please refer to *Appendix 5: Questionnaire*). Depending on the results of the questionnaire, one can distinguish the important factors.

c) An *interview* session with individuals from a number of organizations (for more information please refer to *Appendix 7: Interview Logs*). The interview sessions are complementary to the questionnaire. Two organizations have been selected for the interview:

- ***ABN AMRO Bank/Dutch Business Council, Dubai:*** The person to be interviewed works for the ABN AMRO bank in Dubai and is well informed of the business environment of Dubai. Moreover, he is currently the chairman of the Dutch Business Council in Dubai. This organization serves to promote networking activities between Council members, businessmen and authorities. Furthermore, it serves to promote the interests of the Dutch business community in the U.A.E.

- ***Dubai International Financial Centre*****:** The DIFC serves as a financial centre serving primarily the region between Western Europe and East Asia. The person to be interviewed is an expert in the insurance division. Living and working in Dubai for 15 years, this interview will serve the thesis in terms of being able to interview someone who is acquainted with Dubai's economic development.

- ***Nakheel:*** Nakheel is the biggest real estate developer in Dubai**.** 3 individuals were willing to participate in our interview. The most influential interview for the thesis, with the Development Director of Waterfront City, will give us a clear perspective of the new ideas that Dubai has in terms of creating new business/residential areas and landmarks. The interview is set with three Dutchmen, which will also give us insight regarding the working and living climate in Dubai from a non-local perspective.

- ***Dubai Airport Free Zone:*** The Free Zone within the boundaries of Dubai International Airport is in line with the greater strategy of promoting Dubai as a successful global hub for business, trade and investment. This is a great opportunity to get useful insight regarding the attractiveness of the Free Zone(s) in Dubai for international businesses.

The interview sessions have been deliberately included as part of the field research. The interviews serve as a complementary exploration, adding more depth and possible understanding to the results of the questionnaire. Moreover, the interview is held with organizations that focus more on attracting and/or encouraging foreign companies to operate in Dubai. Whereas the purpose of the research is to specifically investigate the important factors of (Dutch) SMEs to operate in Dubai, the interview will be held with supporting institutions that have a profound knowledge of the business environment in Dubai. They could explain why Dubai has become more attractive for SMEs as well, only from different perspective.

3.5 Empirical Results

It was outlined in section *3.4 Sampling Procedure & Techniques* the research was to be carried out in two methods;

1. *Questionnaires*; The questionnaire served to explore and examine the factors for Dutch SMEs to invest in Dubai. A total of number of 9 companies responded to our questionnaires, brining the response rate to around 18% (see table IV.1).

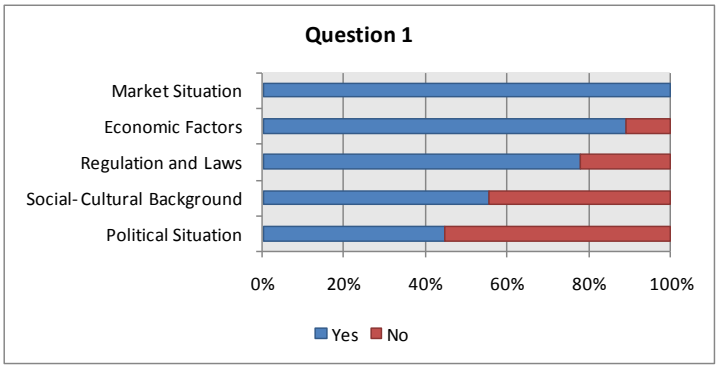
Table IV.1 Questionnaire Response Details		
Non-response	22	43%
Received response	9	18%
Does not fit criteria	9	18%
Unreachable	11	22%
Total	**51**	100%

2. *Interviews:* The interview sessions are complementary to the questionnaire, adding more depth and possible understanding to the results of the questionnaire. Six people from three different organizations were interviewed, with a total interview time of five hours (for more information please refer to *Appendix 7: Interview Logs*).

Given that the interview sessions are complementary to the questionnaires, the results will be presented and analyzed in the same manner; the results of the questionnaires will be presented and where necessary, they will be supplemented with answers gathered through the interview sessions. Information gathered through the interview sessions not related to the questionnaires will be presented separately.

Results of Questionnaires

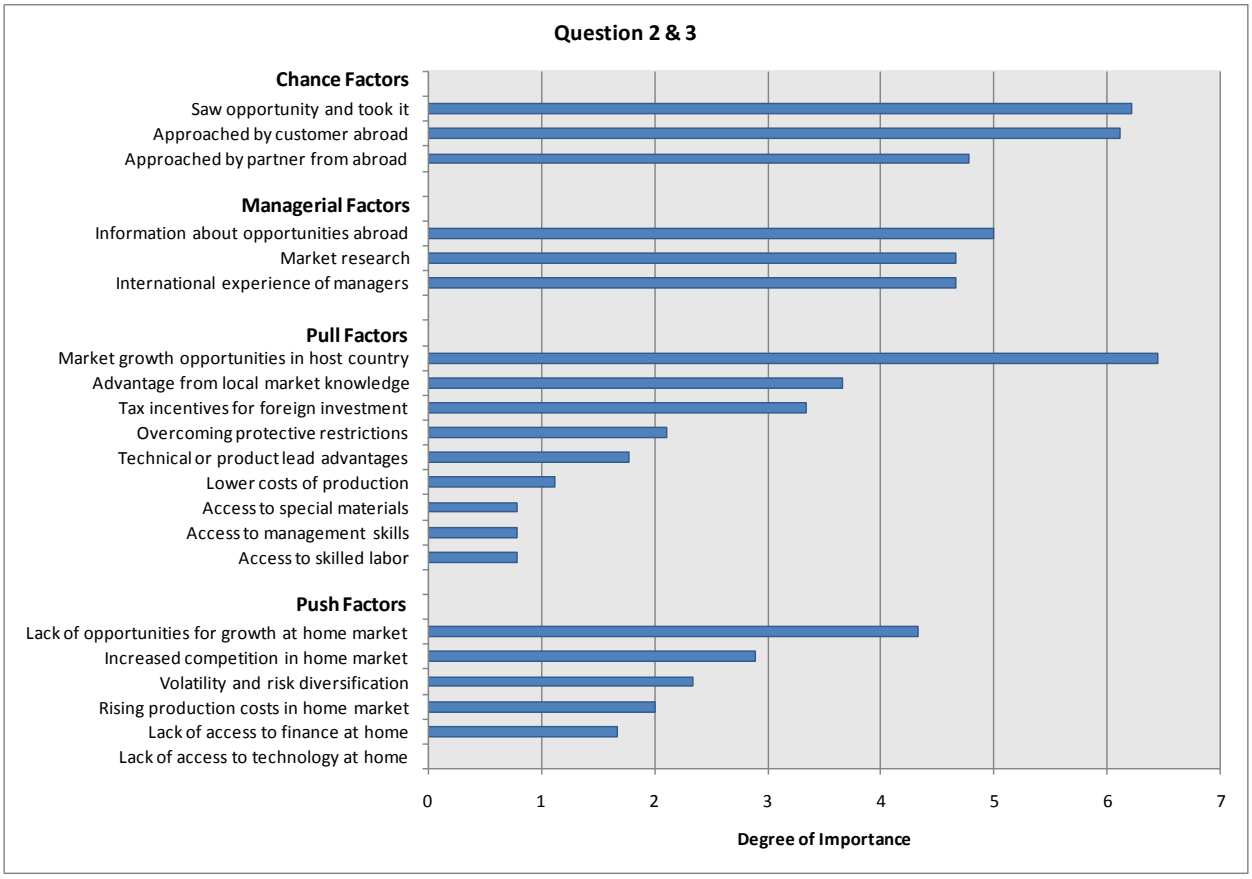
Question 1: To the question *"What kind of information was gathered about the host country (U.A.E.), before entering the country?"* the answers were as follows:



The answers here show that *Social-Cultural Background* and *Political Situation* of Dubai were considered less important for Dutch SMEs before entering the emirate and that gathering information about the "pure" business elements (e.g. Market Situation) were considered more important. However, one of the crucial factors for SMEs to

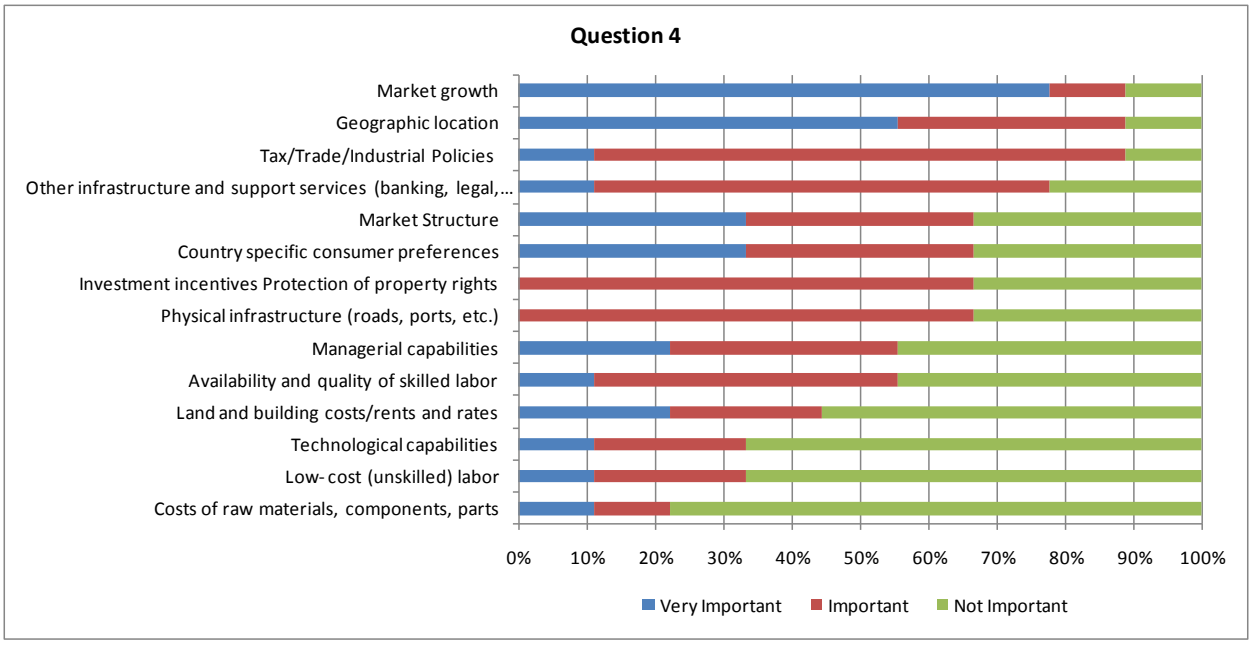
be successful in Dubai according to the interviewees was an adequate understanding of Dubai's social-cultural background and political environment. One of the most frequent mentioned examples during all of the interviews was **relationship-building** (e.g. building lasting relationships with clients, selling one's capabilities, networking). According to one interviewee, new establishments (especially Dutch SMEs) having difficulties with grasping this concept perform worse than their competitors and contribute this underperformance to rigid bureaucratic system and unfriendly business environment. These cultural differences can be traced to Hofstede's (2000) explanation of cultural differences/dimensions between countries. According to Hofstede, the Netherlands has a society of a highly individualistic character and loose bonds, whereas the majority of the population of the UAE is more collectively oriented. One interviewee depicted this cultural difference as *Innocent & Guild* (in the Netherlands) vs. *Honor and Shame* (in Dubai/the Middle East).

Question 2 & 3: Two different questions were asked in regards to factors having played an important role for the decision of investing in Dubai. The results are presented on the next page (highest possible value is 10).



The results of these two questions are not surprising, in the sense that they are in line with the theories explained in section II (see *2.2.4.1 Home country determinants of FDI?* and *2.3.4.1 Kuo, H-C & Li's Conceptual Framework*). However, when combining the most important factors (all factors with a degree of importance > 3), one is able to identify the strategy Dubai has adopted in attracting FDI. According to one interviewee, by creating favorable environment (e.g. the Free-Zone models, tax incentives) for bigger companies to invest in, Dubai has been able to attract those SMEs which are directly involved in the distribution-chain of the bigger companies. In addition, other SMEs are also likely to be attracted by the high market growth opportunities and spillover effects from the bigger companies.

Question 4: Given that only companies considered being active in Dubai were selected (mainly because of methodological reasons), they were asked to identify those factors which have contributed to their "successful" presence in Dubai. The answers were as follows:



As indicated in section I & II (see *1.3 Methodology*, *2.3.4.2 Identifying Factors for FDI* & *2.3.4.3 Success Factors SMEs Abroad*) the results of this questions is aimed as a benchmark for questions 2 & 3. Clearly, by combining the results of questions 2, 3 and 4, it can be seen that SMEs have been motivated to invest in Dubai because of market growth opportunities/ incentives and this has primary contributed to their current success in Dubai. This latter was also the view expressed by all interviewees.

Besides inferences about financial performances of the SMEs, one is also able to point out the importance of Dubai in SMEs strategic plans and the competencies of the SMEs as compared to the local competitors. For example, one of the most frequent mentioned reasons by interviewees concerning why SMEs invest in Dubai was to use Dubai as regional hub to expand their businesses. It can be noted here, that together with Dubai's FTZ-model, Dubai is indeed a rational choice for this purpose. The respondents' answers regarding geographical location, incentives and infrastructure/support services serve only to justify this latter. In regards to SMEs competencies, one can state that those are technological capabilities and managerial capabilities; e.g. although those factors were considered to be unimportant during the FDI decision making process (see question 2 & 3), they have actually contributed to the SMEs success in Dubai.

Question 5: To the request to grade Dubai as place for FDI, the respondents gave an average grade of 7.6 out of 10. This is not surprising, given that all the companies have been successful in Dubai.

Results from Interviews

The questionnaire was designed to explore and examine the factors for Dutch SMEs to invest in Dubai. During the interview sessions, additional information was gathered not directly related to the questionnaire, but which nevertheless is important to mention given the scope of this paper;

- **The Brand Dubai**: Dubai is one of the best known markets of the Middle-East, if not the emerging world. The interviewees found this aspect to play an equivalent important role next to other important factors during the FDI decision making process. The rational is that if a company (e.g. SME) is faced with a decision between Dubai and other Emirates/neighboring country (e.g Bahrain, Qatar), it is more likely to opt for Dubai given the status of Dubai as a business hub, *ceteris paribus*. This has been, according to the opinions expressed in the interviews, achieved by years of marketing and can be traced back to the period when Dubai was dealing in pearl/gold (see *3.2 The UAE in more detail*). This can thus be viewed one of the main successful strategies Dubai has been following over the years.

- **The FTZ Model**: Another mentioned successful strategy that Dubai has been using to attract FDI is the successful implementation and expansion of the Free Trade Zone (FTZ) model. There was a great coherence among the interviewees that the success of Jebel Ali Free Zone (JAFZA) could be linked directly to the success of Dubai as a whole (see for empirical confirmation W. Jacobs [2007]). The spillover effects resulting from the success of JAFZA has not only strengthened Dubai as a main business hub for enterprises (including SMEs), but it has also served as a successful model to be adopted for the future development of other FTZs (see table IV.2). The new FTZs are compared to JAFZA/DAFZA, more focused and aim to provide all the necessary facilities in their given sector (e.g. to serve as a "one-stop shop").

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Table IV.2 Diversification of FTZs in Dubai

FTZ	Inception Year	Sector
Jebel Ali Free Zone (JAFZA)	1985	General, All Round
Dubai Airport Free Zone (DAFZ)	1996	General, All Round
Dubai Internet City (DIC)	2000	ICT
Dubai Gold and Diamond Park	2001	Gold & precious metals, diamonds & colored stones
Dubai Media City (DMC)	2001	Dubai Media City (DMC)
Dubai Techno Park (DTP)	2002	ICT
Dubai Multi Commodities Centre (DMCC)	2002	Gold & precious metals, diamonds & colored stones, energy and other commodities industries
Dubai Knowledge Village (DKV)	2003	Services (training in management, business, human resources as well as education support)
Dubai Industrial City (DIC)	2004	Advanced Engineering (machinery & mechanical equipment, transport equipment, base metals), Agro-Food (food and beverage), Chemistry (chemicals, mineral products)
Dubai International Financial Centre (DIFC)	2004	Banking Services (Investment Banking, Corporate Banking & Private Banking); Capital Markets (Equity, Debt Instruments, Derivatives and Commodity Trading); Asset Management and Fund Registration; Insurance and Re-insurance; Islamic Finance & Professional Service Providers
DuBiotech (DBT)	2005	Agro-Food (plant biotechnology), Biotechnology (pharmaceutics, equine-related biotech, genetics, stem cell research), Environment, Health Care &

		Medicine (medical research, infectious diseases and forensic research)
Dubai Silicon Oasis (DSOA)	2004	Advanced electronic innovation, design, and development
Dubai Maritime City (DMC)	Under development	Multi-purpose maritime centre
Dubai Outsource Zone (DOZ)	Under development	Graphic art, Publishing and Packaging
Dubai Healthcare City (DHCC)	Under development	High-quality healthcare, medical education and research.
Dubai Auto Zone (DAZ)	Under development	Auto Industry catering to buyers, sellers, service providers, principals and traders alike

With the diversification of FTZs, one has attempted to add an extra dimension to the model; the concept of limiting the time and distance between the residential area of workers and their working environment (e.g. DIFC, Waterfront City). By adding this extra dimension, the FTZs are trying to focus even more and differentiate from each other in terms of services available to their clients.

- **Foreign SMEs, Abu Dhabi, Dubai and Economic Sectors:** In section *3.2 The UAE in more detail* an attempt was made to identify the economic sectors attractive for foreign SMEs to invest in and on the basis of that, rationalize the choice of Dubai (and not Abu Dhabi) for the purpose of this study. According to the interviewees, Abu Dhabi and Dubai are focusing on different type of economic sectors and develop their policies/strategies accordingly. Abu Dhabi is more focusing towards establishing itself as a place for companies operating in the energy and/or natural resources sectors. Dubai on the other hand, is lacking the comfort of abundant natural resources and is aiming at attracting companies in the service sector (e.g. part of the diversification of the economy). Due to the SME's personal dimension and limited access to capital (see *2.3.1 Definition of SMEs*), SMEs are more attracted to Dubai. The sectors in which foreign SMEs could play an important role in the future according to the interviewees are[19];

    - **Consultancy:** Currently, there is supply-side marketing approach in Dubai, as manufactures/vendors are aiming at selling their existing products with little or no modifications at all. However, innovation is required for distributers in order to sustain growth. Consultancy could for example, help to turn a supply-side marketing approach to a demand-side one. Foreign SMEs, especially ones with Western supply-side marketing skills, could help to turn this around.

    - **Marketing**; In Dubai, innovation (on a meso- to micro-level) is limited to existing practices (maybe due to lack of innovative skills or lack of statistical information about the progress of innovation), and this gives opportunities for foreign SMEs to invest in.

  Finally, it was also noted during the interviews that the strategies followed by Abu Dhabi and Dubai are to be considered complementary to each other, instead of 1-on-1 competition for FDI. This way, the Emirates can benefit as a whole from FDI into their various economic sectors.

- **The Credit Crisis and SMEs:** In Dubai, there is no immediate impact on SMEs due to limited financing by the banking sector to them. However, indirect impact such as dropping trade volume does have a negative effect on SMEs operating globally. The ultimate effect depends on the sector the SME is operating in; e.g. SMEs dealing in fast moving consumer goods will feel little, but those operating in the real state sector will notice the immediate impact of the global crisis.

[19] Both of these sectors fall according to SIC numbering system, into K.74. By comparing the composition of foreign SMEs in sector K.74 in Dubai (*Table III.1*) and their respective home countries (*Table III.2*), one is able to identify these sectors as well.

- **Sustainability and Dubai:** The sustainability of any economy in the long-run is always what truly matters when deciding to invest in a country (see *2.2.2 Definition and Significance of FDI*). The view among interviewees concerning Dubai's economic sustainability in the long-run given the current economic model was opposing; respondents with local origin were positive while the Western respondents were a bit skeptical. This can be linked to the political and civil liberty in Dubai and the problems involved in performing a research in an aristocratic country. However, they all could agree on that changes are necessary for Dubai to strengthen its position in the long-run, as the current economic model is tailored start-up the local economy. Those changes have to come in regards to the following challenges:

    - *Large population of migrants & long-term commitment:* Dubai main work-force consists of migrants from India, Pakistan and Asian countries. However, little facilities (e.g. housing, rights) are in place to support such a large population. In addition, migrant are treated as "second-class" citizens, with practically no pension arrangement and incentives to be able to commit to a long-term plan to stay in Dubai.

    - *Civil liberty & Ownership:* No matter how liberal the economic environment and policies are (e.g. the rules and regulations in the FTZs are practically copied from the best practices abroad), the UAE is still and aristocratic country providing little civil liberty (e.g. all the local media is government controlled). Moreover, foreigners are restricted in having 100% ownership in local businesses and owning a property is limited to certain areas.

    - *Heavy maintenance infrastructure:* The main proportion of Dubai's infrastructure (e.g. buildings, roads) are relative new (<10 years) and can be considered to be heavy maintenance given the dry climate, increasing traffic and population growth. Without appropriate taxing system, the maintenance cannot be carried out in the long-run.

    The respondents were however, positive in the sense that the government, as opposed to the Western democracies, is more flexible and rapid in implementing the needed changes for Dubai to survive in the long-run. For example, the government has allowed foreigners to own land and is introducing a taxing system step-by-step (e.g. toll-gates on the Al Sheikh Zayed Road). Concerning the question whether introducing tax systems would endanger the very incentive companies decide to settle in Dubai, the respondents were positive, as the benefits of being in Dubai (as a business hub) would outweigh the costs. This is why any type of company planning to invest in Dubai, should have a long-term investment strategy, as Dubai is very flexible in changing its business environment and may look unattractive in the short-run (even with all the incentives available).

Before proceeding to the next chapter, we would like to refer the reader to *Appendix 8: Observational Notes* for the observational notes acquired during the field research in Dubai.

Chapter IV:

Conclusions

IV. Conclusions

4.1 Introduction

In today's global and integrated economy, exogenous economic factors such as FDI can not only stimulate a specific economy, but can promote economic well being across many economies. Given that the significant portion of the capital for FDI originates from and is concentrated primarily in the developed nations (around 85% in 2007 according to the UNCTAD FDI Database), its allocation can in theory be diversified across many regions of the globe. How and on grounds of what this capital distribution and allocation takes place has been subject to a vast amount of research generally channeled towards investments by multinationals corporations (MNCs). The main reason behind this has been the traditional and accepted view that MNCs are the main drivers of economic growth. In modern economics however, small firms have taken a more central role in explaining economic development. The general view nowadays is that SMEs can be considered as possible engines of economic growth. With respect to the internationalization of SMEs, FDI is traditionally considered as the final stage in the development of a firm beginning with the pre-export phase. What we tend to witness however, is that because of changing business landscape as a result of factors such as increasing competition, internationalization of financial services, decreasing costs of conducting international business and increasing mobility, (small) firms do not have to be constrained to their local market before reaching a certain stage of maturity. This increased presence of SMEs in the international business environment, together with the importance of FDI across the globe justifies our research question;

*"Which factors do significantly motivate **foreign SMEs** to invest abroad in terms of FDI?"*

This chapter will begin by answering the research question and it will conclude by discussing possible further research upon the findings of this paper.

4.2 Answer to the Research Question

The research question this paper aimed at investigating was;

*"Which factors significantly motivates **foreign SMEs** to invest abroad in terms of FDI?"*

The answer to this question can according to the research carried out in this paper be classified into three groups; 1) conventional wisdom, 2) contemporary view and 3) case specific. Each of these will be discussed in turn.

Conventional Wisdom

According to the theories and propositions explained in chapter 2, firms are traditionally expected to gradually extend their activities in foreign markets (e.g. *the Uppsala Model*). This process, the so-called *establishment chain*, makes sense logically; foreign start-up firms are not capable to expand to the same extent and manner as MNCs internationally. Although this process has not been the subject of this paper, one could still report on findings which could be linked to the model indirectly (given the gray area between *why* and *how* SMEs invest abroad). According to the surveyed SMEs, the most important factors which have played an important role for the decision of investing in Dubai were *market growth opportunities (in Dubai), lack of opportunities for growth at home market* and *increased competition in home market*. As it is impossible to interpret these findings in isolation, one could infer that modern SMEs follow the establishment chain on a faster pace and that the Uppsala model could hold to

some extent. More importantly and given the scope of the research question, one is able link these three factors to the *product cycle hypothesis* as explained in section *2.2.4.1 Home country determinants of FDI* and applied to SMEs in section *2.3.4.1 Kuo, H-C & Li's Conceptual Framework*. This proposition considers investments by firms in foreign countries as a consequence of slowing local market growth and opportunities to cut costs by investing in foreign markets (e.g. economies of scale and scope). Given the saturation of markets around the globe, increased competition in local markets and the possibility to expand to foreign markets by first establishing an outpost abroad, the product cycle hypothesis seem to hold for the SMEs. Finally, the importance of chance factors during decision making process of investing in Dubai can be linked to the qualitative descriptions of SMEs (see *2.3.2 Definition of SMEs*). Traditionally, the control of SMEs are characterized as being in the hands of a limited number of individuals and hence, the decision making process of for example investing abroad, can be made more rapidly and freely. One would therefore expect to see chance factors play an important role during the decision making process of a SME. Moreover, the proposition that during the decision making process of a SME, personal objectives of the owners play an important role could help explain why there are for example 40 times more Indian companies registered as SMEs[20] in Dubai than Dutch. If one assumes that personal objectives are derived from one's experience, surrounding and culture, then one could infer that because the social and culture proximity (see Hofstede's website) between the Arab world and India is smaller than with the Dutch, one would expect to see more business being conducted between the Arabs and Indians than with the Dutch. The importance of cultural/social and personal elements were also confirmed during the interview sessions and proposed in *2.3.2 Definition of SMEs, 2.3.4.1 Kuo, H-C & Li's Conceptual Framework*, and *2.2.4.2 Host country determinants of FDI*.

Contemporary View

Perhaps at the heart of the contemporary view lies the reduction of spatial barriers (e.g. distance, time and cost) around the globe. This may explain why contrary to the theory about internationalization of firms in section *2.2.4.1 Home country determinants of FDI* but in line with modern theories in *2.3 Small and Medium Sized Enterprises (SMEs)*, determinants such as *Managerial Factors* have played an important role for the decision by SMEs to invest in Dubai. By the reduction of aspects such as distance, time and costs as a result of for example the ITC revolution, young enterprises are able to carry out decent research prior to entering new markets. Moreover, managers may be able to increase their international experience by working for a local firm before deciding to shift operations abroad. This latter was also pointed out as a necessary prerequisite for Dutch SMEs to being successful in a country totally different than their own. The reduction of spatial barriers may also help explain why the results of the research may suggest that the *establishment chain* of the Uppsala model does not hold for the SMEs.

Case Specific: Dubai

The reported findings so far, were considered to fall within the realm of conventional and/or contemporary theory of why SMEs invest abroad. Parts of the result of this paper can considered to be case specific, as there is lack of conclusive evidence (empirically) to support such a generalization. The economic diversification (see *3.2 The UAE in more detail* and *3.3 Dubai; History and Development*) in Dubai for one, has been directed in such a way that it can be considered attractive for SMEs economically. As explained in chapter 3, the economic sectors in Dubai as compared to the other Emirates have been developed in such a way, that they could be viewed as the most logical choice for SMEs to invest in. The results of this strategic move away from oil-focused activities may thus, on paper at least, not only have helped Dubai into creating an economy capable of growing independent of oil, but also

[20] The SME is here referred to as local SME in Dubai. It does not say anything about the actual number of SMEs from India. Instead, it only represents local firms with Indian co-owners. However, given the larger difference between number of the companies with a Dutch origin and Indians, one could expect to find more Indian SMEs having invested in Dubai than Dutch.

capable of attracting investment from SMEs. However, would the same statement be valid when analyzing Dubai in isolation, that is, without the oil giant Abu Dhabi acting as a safety net? If one takes for example the recent collapse of the real estate sector in Dubai, perhaps one of the most significant sectors for FDI, SMEs and the economic diversification, one only have to wonder whether the comment that *Dubai's economy* is resilient enough to recover is justifiable. The interviewees were divided on this matter, with locals being positive and non-locals skeptical. On the one side, we can state that given the rapid growth of Dubai's economy over the years, overcapacity has been created which eventually will lead to a recovery phase. However, we have to also state that on the basis of the findings of this paper, the boom and bust of Dubai's real estate sector can mainly be attributed to speculation driven growth. Speculation on this level has occurred mainly due to lack of laws and regulations in the real estate sector and the media surrounding it. We therefore have to conclude, that Dubai may have been in a different shape without the support of Abu Dhabi's oil-driven economy. As far as the SMEs in real estate are concerned, we believe that SMEs having been drawn into the speculation wave will cash-out and those which are truly conducting business on the basis of sound business models will survive.

Another interesting case specific determinant for SMEs investment is "the brand Dubai". This basically refers to how foreign investors perceive Dubai to be as a place for investment. The interviewees defined Dubai as a multipurpose destination with a certain allure/glamour attached to it. Dubai can for example, be a place for holidays, as there are plenty of activities and iconic buildings to visit. It has impressive shopping centers, and thus can attract shoppers from the entire region. From a theoretical point of view, the tourism/shopping sector can be an attractive sector for foreign SMEs to invest in. Perhaps more importantly, Dubai can serve as a hub for firms aiming at expanding their business in the region. Potential neighboring markets such as North-East Africa, Iraq, Iran, India and China combined with one the world advanced ports, Jebel Ali, and network of ports makes Dubai very difficult to exclude when SMEs are scouting places to establish a business hub. But what differentiates Dubai from the other Emirates/neighboring countries in terms of attracting foreign SMEs? In addition to what already has been mentioned previously, the findings of this paper suggest two major integrated components;

- **The FTZ-Model**; As explained in section *2.2.4.2 Host country determinants of FDI*, free trade zones, special economic zones (SEZs), and export processing zones (EPZs) have a positive effect on FDI as they tend to eliminate hurdles like red tape, regulatory/legal requirements and rigid labor regulations. It could be stated here that Dubai has taken this to extremes after the initial success of the Jebel Ali Free Zone (JAFZA). Today, FTZs can be found for almost any segment of the economy (see table IV.2) and aim to provide all the necessary facilities in their given sector. Combining these phenomena with the theory that firms may benefit from cluster activities such as *industrialization factor economies* (e.g infrastructure, the degree of industrialization, existing FDI stock) and *localization economies* (e.g. specialized labor pools, technological spillover, vocational training, and political lobbies), we can state that the business/investment climate for FDI in Dubai is being optimized. This could be considered to be even more important in attracting FDI by foreign SMEs, as SMEs are by definition driven by focus, specialization and flexibility. Dubai may be seen as the frontrunner in this field, as in the region the FTZ-model has been imitated and implemented, but the same results as Dubai are yet to be achieved. We therefore expect that as the development of the new and more specialized FTZs continue in the future, and as the technological innovation and know-how continue to shift from the Western World to Middle-East/ India/China, more SMEs are likely to be attracted to Dubai. However, this highly depends on whether the Western economies (in particular USA) are able to re-establish their reputation

as technological leaders and continue the brain drain of scientists and great minds from around the globe.

- **Incentives**; What also has contributed to the success of "the brand Dubai", has been the many incentives introduced by the government of Dubai to attract FDI. In section *2.2.4.2 Host country determinants of FDI*, it was mentioned that empirically, the positive relationship between incentives and FDI was not conclusive. However, the same empirical evidence suggested that the positive relationship may hold for smaller firms. The findings of this paper show that incentives are indeed considered important as a pull factor for FDI by SMEs. On the other hand, the results also raise the question of their sustainability and effectiveness in the future. The economy of Dubai has grown greatly over the past 25 years, and the initial introduced incentives for foreign investors are not rational anymore. Heavy maintenance infrastructure, increasing traffic and population growth demand appropriate taxing system in order for the economy to be sustainable in the long-run. Its effect on the FDI by SMEs is unclear, as one would expect the FDI by SMEs to drop as a consequence of disappearing incentives at the one hand while on the other, one would expect no effect given the potential of spillover effects by the existing firms and cluster activities. However, the current economic crisis will have some negative effect on the FDI by SMEs by driving the unprofitable SMEs out of Dubai, while forcing the more solid ones to shrink and minimize costs in order to survive. The true magnitude of the economic crisis on the FDI by SMEs depends on *1) the sector in which the firm is operating*, *2) the economic health of the country of origin*, *3) the goal of the management (e.g. speculative, short-term)* and *4) the period of time active in the local economy.* One would expect that FDI by SMEs active in the sector *K Real Estate, Renting and Business Activities* to decrease substantially in the future given the current crises and overcapacity created in the sector. Given the global crisis, one would also expect that the total FDI, and thus also that from SMEs, in Dubai to decrease in the near future. Foreign SMEs from the risk-averse nations such as the Netherlands may find the costs of sitting the current crisis out in Dubai too high and may thus start to retreat. However, SMEs originating from countries such as India and Iran (with closer cultural proximity and risk-perception) may have little choice but to try to survive. Abandoning operations in Dubai may be even more difficult for SMEs without a foreign home base or for those with a long-term view in mind. On the basis of the research and findings of this paper, we think that investments by SMEs may continue to grow in the future, although not in the same manner as the overall growth of FDI in the past, if Dubai is able to recover from the current crisis while at the same time work on improving the social and moral hazards like smuggling, human trafficking and prostitution it is currently facing. As SMEs have a certain personal dimension, they are more likely to be repelled by these social and moral hazards than MNCs do.

4.3 Remarks and Further Research

In order to answer the research question this paper took the Dutch SMEs having invested in Dubai as a proxy for the total population of foreign SMEs in Dubai (see for the rational *3.4 Sampling Procedure & Techniques*). The factors which were considered important were discussed and presented in detail in *3.5 Empirical Results*. In addition, the information gathered through interviews was used to elaborate on certain issues and explain other important developments in Dubai. The question that now has to be answered is whether there is sufficient evidence at this point to draw a general conclusion on the basis of the findings from the sample taken, and whether they can be considered as being significant. In regards to the former, one would be able to draw a partial conclusion in regards to the Western developed countries. This has mainly to do with the selection of the home countries on the basis of economic (/cultural) proximity. However, one is not able to extend that to other foreign

IV. Conclusions

SMEs, as the authors expect totally different results from SMEs originating from for example Iran or India. This view was also shared by respondents during the interview sessions. To the question why there were almost 40 times more companies with Indian origin than with a Dutch registered in the Dubai Chamber of Commerce & Industry, one respondent linked the difference to cultural and economic differences between the two countries. The Dutch are risk-averse, lack entrepreneurial spirit and live in a stable and attractive economy. The Indians migrating to Dubai on the other hand, have little to live for in their home country, are forced to take risks and have a more entrepreneurial mindset. One would then have to assume that push factors play a more important role for SMEs originating from India than they do for Dutch SMEs, which could be true given the results from the questionnaires. In other words, one would be able generalize the findings of this paper to the Western developed economies (see *Appendix 1* for a complete list of these countries).

In regards to the significance of the results, the authors are skeptical given the relative small sample. For a more conclusive analysis in regards to the Dutch SMEs, the penetration rate would have to be increased. To be able to state any concluding remarks in respect to other foreign SMEs origination from the developed economies (e.g. USA/UK), the sample size has to be increased to include candidates from those countries.

One other shortcoming of this research has been the explicit focus on *successful* foreign SMEs in Dubai, which is an inherent consequence of having been practical during the formulation of the research question. To include all the foreign SMEs (those that have actually settled in Dubai and those that have not), one would have to approach all possible SMEs in their *home* country. This latter was naturally unpractical given the limited resources available to the authors. Nevertheless, during the interviews the respondents did express *their views* concerning why Dubai would be considered as an unattractive place for foreign SMEs (especially those from Western countries) to invest in;

- **Foreign Ownership**: Foreign companies, in particular foreign SMEs, are not keen to share 51% of their shares with foreigners (this can be linked to the personal dimension involved with SMEs; see *2.3.2 Definition of SMEs*). This together with the fact that there are no bankruptcy laws, Dubai provides little protection for foreign investment. This view is also supported by the Doing Business Rankings[21], published yearly by the World Bank Group (see table IV.1). It can clearly be seen, that in terms of protection, and providing projection for foreign investment, the UAE is one of the worst countries in the Middle East & North Africa. However, the UAE ranks fifth in the overall ease of doing business ranking.

[21] http://www.doingbusiness.org/

Table IV.3: Selective dimensions of World Bank Group's Ease of Doing Business Rankings								
Economy	Ease of Doing Business Rank	Starting a Business	Getting Credit	Protecting Investors	Paying Taxes	Trading Across Borders	Enforcing Contracts	Closing a Business
Saudi Arabia	1	2	2	2	3	3	14	6
Bahrain	2	5	4	5	6	4	9	1
Israel	3	1	1	1	12	1	6	4
Qatar	4	7	12	8	1	7	5	2
the UAE	5	12	3	11	2	2	15	17
Kuwait	6	15	4	2	5	13	4	9
Oman	7	9	10	8	4	16	7	7
Tunisia	8	3	4	16	15	8	3	3
Yemen	9	6	17	15	17	17	1	11
Lebanon	10	11	4	8	10	11	10	14
Jordan	11	14	10	11	7	10	13	12
Egypt	12	4	4	6	18	5	17	15
Morocco	13	8	12	17	16	9	8	8
West Bank and Gaza	14	17	15	4	8	12	11	18
Algeria	15	16	12	6	19	15	12	5
Syria	16	13	19	11	13	14	19	10
Iran	17	10	4	17	14	18	2	13
Iraq	18	19	15	11	9	19	16	18
Djibouti	19	18	17	19	11	6	18	16

- **Requirement of a "Local"**: Even if a Western SME is prepared to accept the 49% foreign ownership barrier, it is still faced with other difficulties in regards to marketing and establishing a brand. A company, if pressured by the local partner, has no choice but to adapt its name to include some prefix or change it all together (e.g. "Al Mustafa" Automotive Partners – with the BMW logo next to it). This has been witnessed firsthand by the authors during the exploratory phase of the research in Dubai.

The authors therefore see sufficient possibilities for further research on FDI by SMEs. One could for example focus more on the internationalization process of SMEs by taking into account the reduction of spatial barriers. One could also investigate the attractiveness of the FTZs for SMEs in particular, given the success of the FTZ-model in Dubai. Finally, and perhaps more interestingly, one could perform a comparative study about the attractiveness of the business environment for SMEs in similar locations such as Bahrain, Qatar and Singapore.

Appendices

Appendix 1: Country Classification According to UNCTAD

Developed Countries			Transition Economies	
Austria	Iceland	Spain	Albania	Turkmenistan
Belgium	Ireland	Sweden	Armenia	Ukraine
Belgium and Luxembourg	Italy	Switzerland	Azerbaijan	Uzbekistan
Cyprus	Latvia	United Kingdom	Belarus	
Czech Republic	Lithuania	Australia	Bosnia and Herzegovina	
Denmark	Luxembourg	Bermuda	Bulgaria	
Estonia	Malta	Canada	Kazakhstan	
Finland	Netherlands	Israel	Kyrgyzstan	
France	Norway	Japan	Macedonia, TFYR	
Germany	Poland	New Zealand	Moldova, Republic of	
Gibraltar	Portugal	United States	Romania	
Greece	Slovakia		Russian Federation	
Hungary	Slovenia		Serbia and Montenegro	
			Tajikistan	

Developing Countries				
Afghanistan	Cape Verde	Falkland Islands	Kiribati	Montserrat
Algeria	Caribbean	Fiji	N. Korea	Morocco
Angola	Cayman Islands	French Guiana	S. Korea	Mozambique
Anguilla	Central Africa	French Polynesia	Kuwait	Myanmar
Antigua and Barbuda	Chad	Gabon	Lao People's D.R.	Namibia
Argentina	Chile	Gambia	Lebanon	Nauru
Aruba	China	Ghana	Lesotho	Nepal
Bahamas	Colombia	Grenada	Liberia	Netherlands Antilles
Bahrain	Comoros	Guadeloupe	Libyan Arab Jamahiriya	New Caledonia
Bangladesh	Congo	Guatemala	Macao, China	Nicaragua
Barbados	Cook Islands	Guinea	Madagascar	Niger
Belize	Costa Rica	Guinea-Bissau	Malawi	Nigeria
Benin	Côte d' Ivoire	Guyana	Malaysia	Niue
Bhutan	Cuba	Haiti	Maldives	Northern Mariana Islands
Bolivia	Djibouti	Honduras	Mali	Oman
Botswana	Dominica	Hong Kong, China	Marshall Islands	Pakistan
Brazil	Dominican Republic	India	Martinique	Palau
British Virgin Islands	Ecuador	Indonesia	Mauritania	Palestinian Territory
Brunei Darussalam	Egypt	Iran	Mauritius	Panama
Burkina Faso	El Salvador	Iraq	Mayotte	Papua New Guinea
Burundi	Equatorial Guinea	Jamaica	Mexico	Paraguay
Cambodia	Eritrea	Jordan	Micronesia, F.S.	Peru

Cameroon	Ethiopia	Kenya	Mongolia	Philippines

Developing Countries (continued)				
Puerto Rico	São Tomé and Principe	Sri Lanka	Tokelau	United Republic of Tanzania
Qatar	Saudi Arabia	Sudan	Tonga	Uruguay
Reunion	Senegal	Suriname	Trinidad and Tobago	Vanuatu
Rwanda	Seychelles	Swaziland	Tunisia	Venezuela
Saint Helena	Sierra Leone	Syrian Arab Republic	Turkey	Viet Nam
Saint Kitts and Nevis	Singapore	Taiwan Province of China	Turks and Caicos Islands	Wallis and Futuna Islands
Saint Lucia	Solomon Islands	Thailand	Tuvalu	Yemen
Saint Vincent and the Grenadines	Somalia	Timor-Leste	Uganda	Zambia
Samoa	South Africa	Togo	United Arab Emirates	Zimbabwe

Appendix 2: SME Definition U.S.A.[22]

As a practical matter, various laws and regulations throughout the United States provide different implicit and explicit definitions of small business (or at least businesses for which size is deemed a basis for differential treatment). Listed below are some examples provided by Barbieri (1998) including some from States (within the USA) to demonstrate the range of possibilities:

- SIMPLE Pension Plan -- the Savings Incentive Match Plan for Employees (SIMPLE) allows **firms with fewer than 100 employees** to offer a less administratively burdensome pension plan.
- White House Conference on Small Business -- to run as a delegate for the 1995 White House Conference on Small Business an individual must have been an owner, corporate officer, or employee **of a business employing fewer than 500 people**.
- Family and Medical Leave Act -- an employer for purposes of the Act is one who is engaged in commerce and employs **50 or fewer employees** for each working day in 20 or more weeks in the current or preceding year.
- New Jersey Travel Demand Management Program -- any employer with **100 or more employees** is required to monitor and alter employee commuting activities to reduce ozone pollution.
- Nevada Child Care Study -- a 1997 amendment requires employers with **300 or more employees** at one location to study the desirability and need for child care as well as the feasibility of providing on or near-site child care, reimbursing employees for their child care expenses and furnishing child care for persons with disabilities.
- Eligibility for Small Business Administration Programs:

  Size standards define the maximum size that a firm, including all of its affiliates, may be for eligibility as a small business concern for most SBA programs. The SBA has established two widely used size standards - 500 employees for most manufacturing and mining industries and $5.0 million in average annual receipts for most nonmanufacturing industries. However, many exceptions exist. In establishing size standards the SBA considers "economic structure of an industry including degree of competitiveness, average size of firm, start-up costs and entry barriers, and size distribution of all firms in the industry, technological changes, competition from other industries, growth trends, historical factors in the industry, unique factors, and domination of a firm(s) in an industry". (NFIB, 2000, p.2) The general range of size standards by industry division follows (SBA, 2000):

  - **Construction** - General building and heavy construction contractors have a size standard of **$17 million in average annual receipts**. Special trade construction contractors have a size standard of $7 million.
  - **Manufacturing** - For approximately 75 percent of the manufacturing industries, the size standard is **500 employees**. A small number have a 1,500-employee size standard and the balance have a size standard of either 750 or 1,000 employees.
  - **Mining** - All mining industries, except mining services, have a size standard of **500 employees.**
  - **Retail Trade** - Most retail trade industries have a size standard **of $5 million in average annual receipts**. A few, such as grocery stores, department stores, motor vehicle dealers and electrical appliance dealers, have higher size standards. None are above $21 million.

[22] *Definition of Small Business – Final Report-Holmes & Gibson, 2001, p.28*

- **Services** - For the service industries, the most common size standard is **$5 million in average annual receipts**. Computer programming, data processing and systems design have a size standard of $18 million. Engineering and architectural services have different size standards, as do a few other service industries. The highest annual receipts size standard in any service industry is $21.5 million.
- **Wholesale Trade** - For all wholesale trade industries, a size standard of **100 employees** is applicable for loans and other financial programs. When acting as a dealer on Federal contracts set aside for small business or issued under the 8(a) program, the size standard is 500 employees and the firm must deliver the product of a small domestic manufacturer, as set forth in SBA's nonmanufacturer rule, unless waived by the SBA for a particular class of product.
- **Other Industries** - Other industry divisions include: Agriculture; transportation, communications, electric, gas, and sanitary services; and finance, insurance and real estate. Because of wide variation in the industry structure of the industries in these divisions, there is no common pattern of size standards.

Appendix 3: SME European Definition.[23]

European Union

The definition of small and medium-sized enterprises adopted by the commission in 1996 is (CEC, 1996):

Article 1

1. Small and medium-sized enterprises, hereinafter referred to as SMEs, are defined as enterprises which:

- have **fewer than 250 employees**, and
- have either,
  - an **annual turnover not exceeding ECU 40 million**, or
  - an **annual balance-sheet total not exceeding ECU 27 million**,
- **conform to the criterion of independence** as defined in paragraph 3.

2. Where it is necessary to distinguish between small and medium-sized enterprises, the small enterprise is defined as an enterprise which:

- has fewer than 50 employees and
- has either,
  - an annual turnover not exceeding ECU 7 million, or
  - an annual balance-sheet total not exceeding ECU 5 million,
- conforms to the criterion of independence as defined in paragraph 3.

3. Independent enterprises are those which are not owned as to 25 % or more of the capital or the voting rights by one enterprise, or jointly by several enterprises, falling outside the definition of an SME or a small enterprise, whichever may apply. This threshold may be exceeded in the following two cases:

- if the enterprise is held by public investment corporations, venture capital companies or institutional investors, provided no control is exercised either individually or jointly,
- if the capital is spread in such a way that it is not possible to determine by whom it is held and if the enterprise declares that it can legitimately presume that it is not owned as to 25 % or more by one enterprise, or jointly by several enterprises, falling outside the definitions of an SME or a small enterprise, whichever may apply.

4. Where it is necessary to distinguish micro-enterprises from other SMEs, these are defined as enterprises having fewer than 10 employees.

It is interesting to note that in a recent communication outlining the Unions' strategic goal to "become the most competitive and dynamic knowledge-driven economy in the world" (CEC, 2000, p.2), modified definitions have emerged. For example the suggested
eligibility for an SME guarantee facility is "to cover lending to SMEs with **less than 100 employees**" (CEC, 2000, p.24).

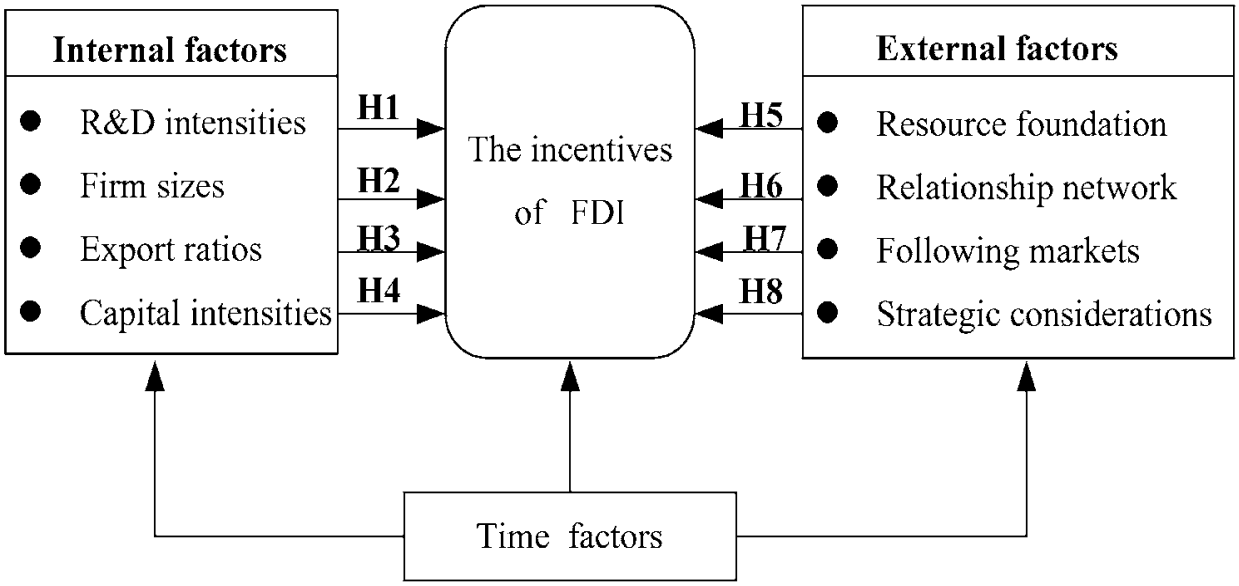
[23] *Definition of Small Business – Final Report-Holmes & Gibson, 2001, p.30*

Some country specific definitions (which deviate from the CEC recommendations) include:

The Netherlands: The SME Policy Unit in the Ministry of Economic Affairs uses the following definition – a SME is one with **less than 100 employees**, a small business is one with less than 10 employees and a medium-sized enterprise has 10 – 100 employees.

Ireland: The 1994 Task Force on Small Business defined a small enterprise as one which **employs fewer than 50 employees** and has **annual revenue of less than IR 3 million**. A medium-sized enterprise is one with 50-250 employees and large enterprises have more than 250 employees.

Appendix 4: The conceptual framework of the incentives of FDI.



Appendix 5: Questionnaire

This questionnaire is part of a Master thesis by H. Asarzadegan and J.M. Kaluf from the Erasmus University in Rotterdam. The main focus of the research is to find the key determinants for Dutch SME[24] investing and currently operating in Dubai (U.A.E).

Therefore, the questionnaire is meant for ***Dutch operating SME*** in Dubai. Questions will be asked regarding the degree of (success)-factors playing an influential role in going abroad to the respective Emirate.

In the following section of this questionnaire, some basic data are requested regarding your company. This is followed by 5 central questions. These questions include factors that may have led your particular company to operate in Dubai. Please assess the factors in relation to your company for each particular question. An appendix is included as a support tool explaining the individual factors (*) laid out in the questionnaire.

Any information you give us will be treated with the utmost care and will not be used in ways that you have not consented to.

---

[24] SME (= Small and Medium Sized Enterprises)

Basic Data

Type of Industry: … Number of Employees: …

Number of years in U.A.E.: …

(Success) Factors

1. Which of the following information was gathered about the host country (U.A.E.), ***before starting*** to operate abroad? (Please answer yes or no for each category).

   ➔ *Market Situation Yes/No

   ➔ *Social- Cultural Background Yes/No

   ➔ *Political Situation Yes/No

   ➔ *Economic Factors Yes/No

   ➔ *Regulation and Laws Yes/No

2. For the following, please indicate if the factor mentioned was a factor considered for Foreign Direct Investment (FDI) in the U.A.E. (1 if the factor **was considered** to have the intention of conducting FDI: 0, otherwise)

*Securing raw-material supply	…	(0 or 1)
*Utilizing local labor	…	(0 or 1)
*Accessing cheap land	…	(0 or 1)
*Following major clients (vertical network)	…	(0 or 1)
*Investing with other firms in same industry (horizontal network)	…	(0 or 1)
*Expanding markets	…	(0 or 1)
*Collecting market information	…	(0 or 1)
*Capitalizing on tax incentives	…	(0 or 1)
*Acquiring key or new technologies	…	(0 or 1)

3. Which of the following factors **have played** an important role to your company starting to operate in Dubai? (Please grade for each factor between 1-10, with 1 being the least important factor and 10 being the most influential).

Push Factors	Important? (yes/no)	Grade (1-10)
Lack of opportunities for growth at home market		
*Lack of access to finance at home		
*Lack of access to technology at home		
Rising production costs in home market		

Increased competition in home market		
*Volatility and risk diversification		
Pull Factors		
Access to skilled labor		
*Access to management skills		
Lower costs of production		
Market growth opportunities in host country		
Tax incentives for foreign investment		
Access to special materials		
*Overcoming protective restrictions		
*Advantage from local market knowledge		
*Technical or product lead advantages		
Managerial Factors		
*International experience of managers		
*Information about opportunities abroad		
*Market research		
Chance factors		
Approached by customer abroad		
Approached by partner from abroad		
*Saw opportunity and took it		

4. The following factors can be considered **important success factors** for our company when operating in Dubai? (Please mark with a cross (X) for each factor given, whether the factor mentioned is considered **not important**, **important** or **very important**).

	Not Important	Important	Very Important
Market growth			
Country specific consumer preferences			
*Market Structure			
Land and building costs/rents and rates			
Low- cost (unskilled) labor			
Availability and quality of skilled labor			
Costs of raw materials, components, parts			

*Technological capabilities			
*Managerial capabilities			
Physical infrastructure (roads, ports, etc.)			
Investment incentives Protection of property rights			
Other infrastructure and support services (banking, legal, accountancy services)			
Geographic location			
Tax/Trade/Industrial Policies			

5. What overall grade would you give Dubai as a place for Foreign Direct Investment? (1 is the lowest and 10 the highest mark).

|-----1-----2-----3-----4-----5-----6-----7----8-----9-----10-----|

Appendix

The factors with a * in the questionnaire are briefly explained in this section.

- ***Question 1 → the question discusses the preparation phase of operating abroad. What kind of information did your company collect about the U.A.E. (Dubai)?***

Market Situation = these are specific market conditions related to your company's industry.
Social- Cultural Background = socio-cultural factors of the host country, in this case the U.A.E. Norms and values of the specific geographical region.
Political Situation = the political infrastructure. Democratic values related to economic freedom. The degree of free market movement versus market intervention should be considered. Political institutions and other supportive organizations for Dubai's (economic) development are included here.
Economic Factors = these include economic (macro-) indicators. Indicators include all kinds of information such as GDP, inflation rate, foreign direct investment.
Regulation and Laws = all policies that discourage or helps the individual entrepreneur to start and operate his/her business.

- ***Question 2 → second phase in FDI decision making. When taking into account the factors whether your company should go abroad, which factors were considered and which were not? In this phase some general factors are discussed that are usually industry-specific.***

Securing raw-material supply = important raw materials can be attained if going abroad to U.A.E. (Dubai)

Utilizing local labor = local labor of the U.A.E. (Dubai) have specific qualities that fits into the company general operational goals and strategy.
Accessing cheap land = making use of cheap lands for the company's operations (in order to expand and/or decrease costs)
Following major clients (vertical network) = clients in the supply chain already operating in U.A.E. (Dubai) attracting your company as well. This is mostly done in order to exploit opportunities in a new market and to strengthen the supply chain (internationally).
Investing with other firms in same industry (horizontal network) = working with one or two other competitors in a joint operation or joint venture.
Expanding markets = important consideration for a company if it wants to expand its market coverage (by moving in this case to Dubai).
Collecting market information = considerations regarding valuable market information can be acquired by operating in another (international) market.
Capitalizing on tax incentives = tax relief will improve a company's financial performance because of the lesser financial burden.
Acquiring key or new technologies = specific technologies important for the company's operation and competitive strategy can be used and acquired when going abroad.

- ***Question 3 → final phase in FDI decision making. Which factors did actually contribute to the company's decision to operate in Dubai? All important factors are mentioned which need to be evaluated accordingly (including the degree of importance).***

Lack of access to finance at home = a push factor describing the absence of financial access in the home market which can force a company to engage in foreign direct investment elsewhere. Access to finance can give companies the ability to capitalize on investment opportunities and projects.
Lack of access to technology at home = a push factor describing the absence of key technologies in the home market. Technological access is closely linked to innovativeness which in turns lead to higher efficiency and performance.
Volatility and risk diversification = due to risks involved operating in one country or region, a company could opt to diverse its operations and consequently its business risks. Going abroad in this case makes the company less vulnerable to (negative) market conditions in one place.
Access to management skills = specialized and good managements skills can be a critical factor for many companies to choose for a certain country/region.
Overcoming protective restrictions = going abroad is attractive for the company because operating in the host country (Dubai) has lesser barriers (including laws and regulations, bureaucracy). This suggests free market competition, without (too much) protection.
Advantage from local market knowledge = a factor that implies the company will go abroad because it possesses valuable knowledge of the host country market (Dubai). This market understanding gives the company a competitive edge to invest.
Technical or product lead advantages = when choosing to operate in the international market possible technical and/or product advantages might be realized, which gives improvement to the company's overall competitive position.
International experience of managers = a managerial factor addressing experience as a motive to move abroad. The availability of experienced managers in the host market can convince a company to engage in Foreign Direct Investment (FDI).
Information about opportunities abroad = a managerial factor where opportunities of investing in the host market becomes noticeable by managers (through networking). The identification of these opportunities is an important point in the process of engaging in Foreign Direct Investment (FDI).
Market research = the next (and final) step in information gathering. Deliberate research of the host market to assess the opportunities and consequently developing an appropriate strategy to operate abroad.
Saw opportunity and took it = the company's decision to operate abroad was mostly determined by a sudden opportunity. Accordingly the company took (immediate) action.

- ***Question 4 → now that your company is operating in Dubai, what would you describe as being the important factors to be successful in your industry?***

Market Structure = the degree and other characteristics of (direct) competitors in combination with the attractiveness of operating in the specific market.
Technological capabilities = the technological potential of a company is important as it can lead to technological advances which improves the competitive position. In certain industry technological ability is more a critical success factor than others.
Managerial capabilities = skilled labor as in qualified and specialized managers can be very important factors of success for a company operating abroad.

- ***Question 5 → after analyzing the previous questions regarding the important factors that apply to your own business, what overall grade would you give Dubai as a place to invest?***

Appendix 6: Interview Questions

1. *Please tell us briefly what your organization does? How does this connect to the FDI of SME?*

   ……

2. *Why would an international company (SME) want **to invest and start its operation** in the U.A.E. compared to other countries in the Middle-East?*

   ……

3. *Which factors can contribute for an SME **being successful** in the U.A.E.?*

   …….

4. *What **strategy** is being used for attracting investment in Dubai? Does this differ from other emirates or neighboring countries?*

   ……

5. *What are the **specific advantages** of Dubai for foreign SME compared to the other Emirates such as Abu Dhabi, Sharjah etc?*

   ……

6. *What local **policies** have significantly contributed to the successful attraction of a number of foreign companies?*

   ……

7. *Finally, do you believe Dubai becoming and/or maintaining the **leading position for attracting foreign companies in the region**? How can this advantage be achieved/maintained?*

   …..

Appendix 7: Interview Logs

1. **ABN AMRO/ Dutch Business Council – Oscar Rijcken-Voigt** (Middle East Regional Project Manager and Chairman of the NBC)
   14th of January, 2009 – at 10.00

2. **Dubai International Financial Centre – Khalil Eid** (Director Insurance & Reinsurance)
   15th of January, 2009 – at 9:00

3. **Nakheel – Piet Cornelissen (**Project Manager Roads Infrastructure, Waterfront)
   18th of January, 2009 – at 9.30

4. **Nakheel – Ralf Laurijsen (**Development Manager Waterfront City)
   18th of January, 2009 – at 10.30

5. Dubai **Airport Free Zone -Nasser Al Madani** (Assistant Director General)
   19th of January, 2009 – at 10.30

6. Nakheel **– Frank Konings** (Development Director Waterfront City)
   21st of January, 2009 – at 10:00

Appendix 8: Observational Notes

Having laid out the different methods of investigation, one should equally take into account the method of observation. The authors intentionally chose to physically explore Dubai for the reason of comprehending the environmental circumstances of Dubai. The reason for this is twofold:

- Understanding the context. After gathering secondary information regarding the role of SME's and FDI in Dubai through reading materials, mouth-to-mouth marketing and pictures one can attain a certain impression and idea regarding the role of Dubai. However, in order to fully understand the background of an in-depth case study one should be present at the place of investigation. It puts the pieces together, it fills in the holes, raises additional questions and makes the exploration of the case more comprehensive. The contexts will be laid out in more detail in the next section.

- Networking. An integral part of doing research in an unknown region/place is having useful sources. These sources or individuals provide new and up-to-date information regarding certain topics (by means of interviewing for example). To obtain new data in the Middle-East region we believe it was important from the beginning to visit these sources in person. Apart from being a cultural consideration, the complementary advantage would be that these sources could point us in the right direction as their knowledge about Dubai extends what have been explored from second-hand data. At this point, networking comes into place. These sources have networks in Dubai and can help us provide additional information from other individuals in Dubai or facilitate in one way or another how to get these information directly.

As mentioned before, the context in which an investigation is carried out must be understood. The authors will try to briefly describe the different contextual circumstances they came across in Dubai. These contextual observations will be used later on as an additional consideration for interpreting the empirical results and conclusions.

Five contextual observations are worth mentioning and will be discussed accordingly:

1. Infrastructure
2. Free zones
3. Demographics
4. Buildings/Construction
5. Tourism

Before explaining these important observations, it is critical to note that the authors will take into account factors that could play a role in subjective interpretations. These are:

- The Netherlands vs. Dubai. The authors, although internationally conscious due to their background and education, will observe new things and try to interpret these to a certain standard. The standard in this case will be (for the most part based on) the Netherlands. This means that Dubai, being a modern place and paving its way to the future, will be compared to the Netherlands in terms of these contextual factors.

- Time of observations. Two important factors should be discussed here. First, the authors visited Dubai for two weeks in January 2009. These two weeks will give a certain view of Dubai but one should be aware of

this one-point-in-time perspective. Dubai has changed dramatically over the last decade, and seeing Dubai in 2009 will only represent a small part of how Dubai looks like. Secondly, at the time of our presence in Dubai the world is experiencing a severe economic crisis which is felt everywhere. Dubai, after years of economic boom, has been also experiencing an economic crisis. Observing Dubai at the time of economic downturn may not only contradict our attained idea (through second-hand data) about Dubai's attractiveness but it will influence the interview and questionnaire results as well. This is perhaps a major shortcoming in our empirical results including the observations made by the authors.

Infrastructure

Here we merely discuss the physical infrastructure, more specifically airport, roads and (lack of) public transportation. Dubai's international airport is large, organized and well managed for travelers. In addition, a great deal of effort has been put in the duty free shopping area. The roads of Dubai are in good condition and there are various connection possibilities. However, some points deserve critical attention. Even though the signs on the road are there most of the times it does not navigate the driver to a specific location. In addition, the exits and entries on the highway are not driver-friendly. The exits are not shown clearly by road signs and when entering the highway a car should stop and insert at a low speed which makes it dangerous at times. The main and perhaps only way of transportation for individuals in Dubai is by car. This puts pressure on the environment, creates traffic congestion and is time-consuming. Moreover, the roads will deteriorate sooner if everyone travels by car. This again puts a lot of pressure on the infrastructural sustainability. The authors did however observe a metro line in construction which could alleviate this problem in the future.

Free zones

Dubai is relatively speaking a small place on the map. However, the amount of free zones constructed for attracting FDI is impressive. Dubai has over 25 free zones for attracting specialized businesses and creating dynamism and competitive advantages. There are two types of free-zones: 1) Mixed free zones, and 2) Specialized free zones. The former is a free zone where many heterogeneous businesses operate near a distributional hub (Dubai Airport Free Zone and Jebel Ali Free Zone). The latter is a free zone with a specific area of specialization (Dubai Financial Center, Dubai Media City and Dubai Health Care City). These Free zones are located across Dubai and many buildings, roads, malls and other service-related activities are built around these zoning areas.

Demographics

The authors have observed many different nationalities in Dubai. However, three nationalities clearly stand out when visiting Dubai. The Indian, Pakistani and Thai population can be seen on a daily basis. They are overrepresented in and around the old Dubai centre and form the backbone of Dubai's economy. In general Pakistani's can be seen working around buildings and construction sites, Indians can be seen owning all kind of (small) businesses and the Thai population are around malls in stores and as security servicing the shopping individuals. The locals are not seen so much except on Fridays and during the night. Moreover, the locals can be seen driving very expensive cars and around the new built-areas of Dubai (e.g. Dubai Marina, Jumeraih, Emirates Hills). The overall age varies from 19-50. There were not many kids seen in Dubai and even less elderly people. Therefore the overall population can be considered in the age of the working class. Finally, it struck us that many people in Dubai are male. There are clearly many more males than females in Dubai. This is especially the case when you consider the migrants.

Buildings/Construction

Dubai's direct attractiveness are the modern and beautiful high-rise buildings. The Burj-Al Arab and the Burj Dubai are immediately observed from (nearly) everywhere. Moreover, the extravagant malls, the indoor ski building, the palm islands just make Dubai unique. It is somewhat difficult to understand what you see when you are in such a

small place (everything is close to each other) and that is what makes it even more unreal. An important note to stress out and perhaps related to the economic situation during our visit was the empty high-rise buildings near the Sheikh Zayed Road. At night when traveling by car to our own accommodation we often drove on the Sheikh Zayed road near the many high-rise buildings holding the apartments. One could only see a few lights turned on at night. This could indicate many apartments not being occupied (yet). Even though this might not be odd at first everywhere and at any given time in Dubai there are continuous projects and constructions being developed. If the current buildings are abandoned or empty, then why build more buildings?

Tourism

Dubai's malls are one of the immediate efforts in attracting tourism from the region and elsewhere. Apart from having amazing malls, many more activities are planned and arranged for tourists. During our visit in January, a yearly shopping festival was held in Dubai. Even though it is suppose to be one of the biggest festivals for attracting tourism, we did not sense so many tourists during our visit. Again, this can be (at least partly) explained by the economic situation.

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