

The relation between domestic competition and export performance

A survey of European exporting firms active in leading export sectors

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Exports outside the EU are substantial, representing in many EU countries (including the largest ones) about 15% relative to GDP.¹ As such, they are important for EU economies and governments should carefully understand and consider the drivers of firms' success in international markets. What role does competition play in determining the export performance of European players?

The pros and cons of domestic competition

Exports may be affected by competition in the domestic markets at two stages: in the firms' own market, and in the upstream markets where the firms purchase the relevant inputs. The economic literature is unanimous in pointing out that effective competition in domestic input markets has a positive effect on export performance, lowering the price and improving the quality of both physical inputs and services. In turn, this allows EU-based firms that use such inputs to be more competitive in international markets.²

With respect to the role played by competition in the exporters' own market, i.e. the domestic market where they operate, the insights from the economic literature are somewhat more mixed. Most scholars argue that firms that face effective competition at home will strive to be more efficient, to make their offer more

attractive for customers through innovation and product differentiation, and will thus be better equipped when competing against their international rivals. Porter (1990) is amongst the strongest supporters of this view. He holds that a nation's competitiveness depends on the capacity of its industries to innovate and upgrade, and that companies benefit from effective competition in their domestic markets, as meeting this challenge forces them to innovate, which in turn gives them an advantage compared to international competitors.³

Some authors, however, suggest instead that a second mechanism prevails, going in the opposite direction.⁴ They argue that more competition in the domestic market may be detrimental to exports, since it prevents firms from reaching the scale that would enable them to compete effectively in international markets. These contributions advocate for governments' intervention to incentivise the creation of "national export champions", even at the expense of effective merger control.

New evidence on the role of competition

We have tested the hypotheses formulated in the economic literature in a study for DG Comp.⁵ In particular, we carried out a survey of European exporting firms that are active in leading export sectors.

The survey involved 11 Member States⁶ and was completed by 398 firms who operate in leading export sectors.

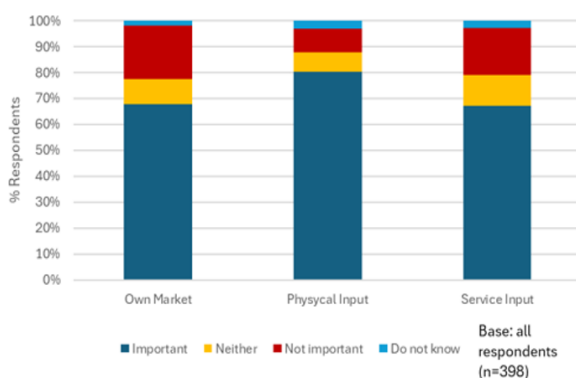
The sample of respondents is mainly composed by small firms and mid-caps (74% are SMEs and at least 14% mid-caps), consistently with Simon (2009), who stresses that successful exporters are not necessarily large firms.⁷ Most of them are established firms (only 2% of firms are less than 10 years old) and export to several non-EU countries (57% of firms declare to export to more than 5 extra-EU countries).

Three main findings emerge from the survey, as detailed below.

The importance of competitive input markets

The first finding is that well-functioning input markets are a key element of an ecosystem that enhances the export performance of European firms. Indeed, competition in upstream markets, particularly for goods, is perceived as one of the main determinants of export success. As shown in Figure 1, 80% of respondents believe that competition in physical input markets is important for export success, compared to 67% for both competitive markets for services and own product markets.

Figure 1: Perceived importance of competition in physical input, services and own product markets for export success



Source: Project Team

We broke down the answers to this question by the perceived level of market concentration (defined based on the perceived number of domestic competitors, i.e. “0-3”, “4-10” and

“10+”). Results show that the percentage of firms that think that competition in services markets and in the market for the own product is important for export success decreases with the perceived level of concentration. Instead, the percentage of respondents that think that competition in physical input markets is important does not depend on the perceived level of own-market concentration: it is very high (about 80%) regardless of that.

It should also be noted that the overwhelming majority of respondents (84%) procure their main inputs in the EU, which confirms that domestic competition in upstream markets can have substantial effects for our respondents.

Competition in the own market positively affects exports

The second key finding is that domestic competition in the own product market is perceived to have a relevant and positive impact on export performance. As anticipated, according to the literature, domestic competition can positively affect exports by incentivising firms to be more efficient, to improve product quality, and to innovate; on the other hand, competition may prevent firms to reach a sufficient scale to be competitive in foreign markets. The relevance of these different channels was tested both through a closed-answer question and through an open-answer question. On the closed-answer question, the large majority of respondents reported that domestic competition has a positive impact on company performance. In particular:

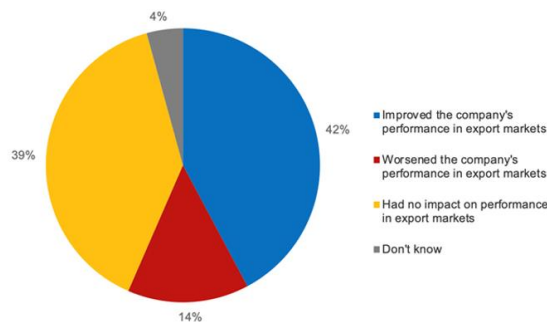
- 85% of respondents said that domestic competition incentivises firms to improve or maintain product quality;
- 84% said it incentivises firms to increase efficiency;
- 78% reported that it increased innovation at the company; and
- the overwhelming majority of respondents disagreed with the statement that competition is detrimental for their performance, and, in fact, 66% of respondents said

that domestic competition does not curb their size in a way damaging their export competitiveness.

These opinion were confirmed by the answers to the open question, which indicated that competition had the virtue of improving firms' quality and fostering innovation. However, some respondents backed the opposite view and a minority even argued that competition has a negative impact because it forces firms to lower prices and margins.

When asked more generally about the impact that domestic competition had on export performance, 42% of respondents said that it improved the company's performance in export markets, 14% that it worsened the company's export performance, 39% that it had no impact on performance in export markets, and 4% did not know. These results are shown in Figure 2. Among the majority of respondents who think that competition has an impact on export success (56%), those who perceive a positive impact (42%) are therefore three times as many as those who perceive a negative effect (14%).

Figure 2: Effect of competitive pressure on performance in export markets

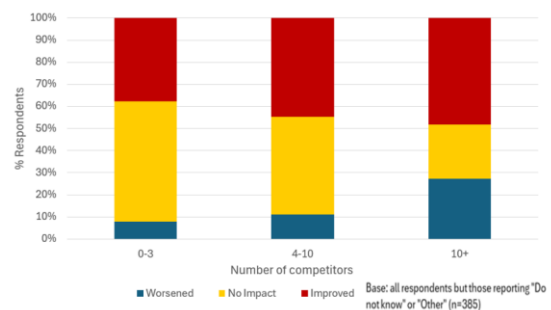


Source: Project Team

The survey also delivers interesting implications on the perceived relationship between the impact of competition in the own market and the export performance. Firms' opinions tend to diverge and to become more polarized in those markets where competition is perceived to be stronger. Indeed, as Figure 3 shows, in markets with many competitors, fewer firms believe that competition does not matter, while in more concentrated markets,

the proportion of respondents who believe that competition has improved export performance or who hold the opposite view become smaller. There may be a good explanation for these seemingly contradictory views. Competition triggers selection with winners and losers. It is not surprising that the latter believe that the intensity of competition is responsible for their low penetration of foreign markets, while the former recognize that the incentives they faced in the domestic market led them to perform well enough to win the competition abroad as well.

Figure 3: Effect of competitive pressure on performance in export markets, by perceived number of competitors in the domestic market

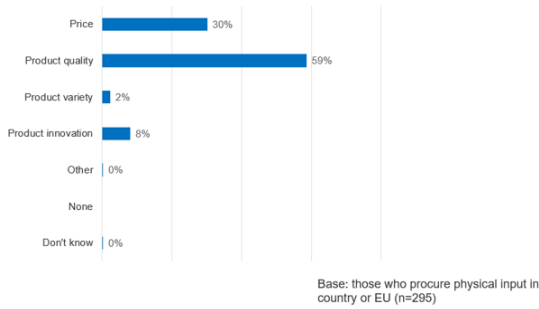


Source: Project Team

The importance of product quality

The third main finding that emerges from the survey is the importance of product quality as the key dimension of competition and of export success. Indeed, quality is identified as the most important aspect of both input products and services for export success. Concerning input products, this is shown in Figure 4, which illustrates that for 59% of respondents the most important factor for export success is quality of the input, followed by price (for 30%), product innovation and product variety (8% and 2% respectively).

Figure 4: Most important aspect of the main input product for success in global export markets

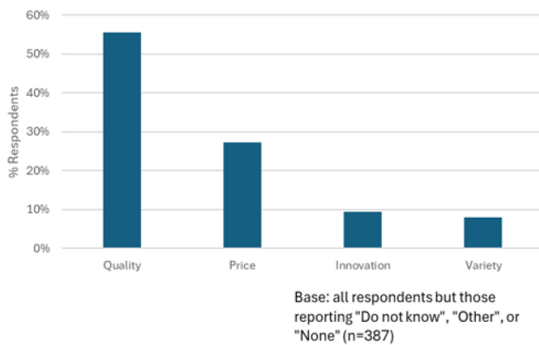


Source: Project Team

Concerning input services, we focused on price and quality as the key factors impacting success in global export markets, and found that for most services, quality of the service is even more important than its price.

Quality is also indicated as the main driver of success in the domestic market for the own product. As shown in Figure 5, about 55% of respondents indicated quality as the main driver for succeeding in the domestic market, 27% reported price, and only 9% and 8% indicated product innovation and variety respectively.

Figure 5: Most important aspect for product success in the domestic market



Source: Project Team

Moreover, product quality is perceived as the main dimension that is affected by domestic competition (followed in order by price, product variety and volume of output). This suggests that improved product quality is an outcome of the competitive process.

Finally, as explained in the previous section, it should be recalled that the incentive to improve quality is perceived by respondents as

the main channel through which domestic competition affects export success.

Conclusion

Competition in upstream markets for goods and services is generally accepted to have a positive impact on firms' export success. However, the literature recognises that due to mechanisms operating in opposite directions, competition in the own product market can either positively or negatively affect exports.

Our survey to European exporting firms active in leading export sectors suggests that domestic competition, both in upstream markets and in the own product market, is perceived to have a relevant and positive impact on firms' success in global markets. Moreover, the survey flags that product quality is a key dimension of competition and of export success, even more than price.

If you would like to discuss these issues further, or if you would like more information about what our economists can do for you, please get in touch with us.

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Notes

¹ We restricted our attention to the 11 economies that are the focus of the study and computed the total export to countries outside the EU with respect to the GDP of these countries. Results show that for many countries exports to extra-EU markets over GDP are about 15%, with even larger numbers for countries such as Belgium (31%) and Netherlands (23%). Although this does not represent the impact of extra-EU trade on GDP (as that is represented by exports minus imports), exports outside the EU represent the positive component of the extra-EU trade to the country and play an important role for the balance of payment position of the country.

² Barone, G., & Cingano, F. (2011). Service regulation and growth: evidence from OECD countries. *The Economic Journal*, 121(555), 931-957; Allegra, E., Forni, M., Grillo, M., & Magnani, L. (2004). Antitrust policy and national growth: some evidence from Italy. *Giornale degli economisti e annali di economia*, 69-86; Ricci, L., & Trionfetti, F. (2011). Evidence on productivity, comparative advantage, and networks in the export performance of firms. IMF Working Paper.

³ Porter, M. (1990). Competitive advantage of nations: creating and sustaining superior performance. *Harvard Business Review*, 68(2), 73-93. Other authors supporting this view are: Clougherty, J., & Zhang, A. (2009). Domestic rivalry and export performance: Theory and evidence from international airline markets. *Canadian Journal of Economics*, 42(2), 440-468; Donghwan, K., & Marion, B. (1997). Domestic market structure and performance in global markets: Theory and empirical evidence from US food manufacturing industries. *Review of Industrial Organization*, 12, 335-354; Hollis, A. (2003). Industrial concentration, output, and trade: An empirical exploration. *Review of Industrial Organization*, 22(2), 103-119.

⁴ Chou, T.-C. (1986). Concentration, profitability and trade in a simultaneous equation analysis: The case of Taiwan. *The Journal of Industrial Economics*, 429-443; Pagoulatos, E., & Sorensen, R. (1975). Domestic Market Structure and International Trade an Empirical Analysis. UMSL Global Occasional Papers, 751; Pagoulatos, E., & Sorensen, R. (1976). International trade, international investment and industrial profitability of US manufacturing. *Southern Economic Journal*, 425-434.

⁵ The study was part of a broader project assessing several aspects of the state of competition in the EU. This wider project was carried out by a consortium led by Lear, including also E.CA Economics, Fideres, Prometeia, University of East Anglia and Verian.

⁶ Germany, France, Italy, Spain, The Netherlands, Belgium, Austria, Poland, Czech Republic, Romania, and Sweden.

⁷ Simon, H. (2009). *Hidden champions of the twenty-first century: Success strategies of unknown world market leaders*. New York: Springer.