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*Review*

## **SME Diversification and Corporate Management under China-Europe Trade Integration: A Framework for Sustainable Growth**

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### **Abstract**

This paper examines corporate diversification and management practices among small and medium-sized enterprises (SMEs) within China-Europe trade integration. With bilateral trade reaching ~US\$780 billion in 2025, SMEs face both opportunities and challenges in diversifying across Eurasia. Drawing on recent evidence, the study identifies three diversification pathways: product, geographic market, and supply chain diversification. While diversification enhances SME resilience during economic disruptions—horizontally diversified firms show lower failure rates—successful implementation demands sophisticated management capabilities that many SMEs lack due to resource constraints, governance weaknesses, and limited regulatory expertise. The paper analyzes key challenges confronting SME managers, including geopolitical tensions (e.g., the suspended EU-China Comprehensive Agreement on Investment), heterogeneous European regulatory environments, and the trade-off between diversification benefits and organizational complexity costs. Policy recommendations emphasize agile compliance monitoring, ESG-integrated governance frameworks, and digital collaborative platforms to reduce diversification transaction costs for SMEs. This research contributes to the literature on SME internationalization amid geoeconomic fragmentation and offers actionable insights for managers and policymakers seeking sustainable growth under the China-Europe trade and investment integration framework.

### **Keywords**

Corporate diversification, Small and medium-sized enterprises, China-Europe trade integration, Corporate governance, Supply chain resilience, Internationalization strategy

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## 1. Introduction

The Belt and Road Initiative and the deepening economic integration between China and Europe have fundamentally reshaped the competitive landscape for small and medium-sized enterprises operating across the Eurasian continent. As China and the European Union commemorate 50 years of diplomatic relations in 2025, their economic partnership has demonstrated remarkable resilience and renewed strength against the backdrop of mounting global uncertainties. Bilateral trade has expanded more than 320-fold over the past five decades and reached approximately US\$780 billion in 2025. In the first quarter of 2025, China-EU trade reached 1.3 trillion yuan, equivalent to about US\$180.5 billion, or more than 10 million yuan in trade every minute [1].

For small and medium-sized enterprises (SMEs), which constitute the majority of enterprises in China and European economies, this deepening economic integration presents both opportunities and risks. On the one hand, the Asia-Europe trade lane recorded 30 consecutive months of growth as of August 2025, creating new opportunities for cross-border expansion. Recent survey evidence further shows that 76 percent of Asia-Pacific SMEs reported increased export volumes to Europe over the past year, while 87 percent of European SMEs trading with Asia Pacific expected their trade balance to shift toward exports or remain at current levels in 2026. China was also identified by 55 percent of surveyed European SMEs as the Asia-Pacific market offering the best opportunities for growth [2].

On the other hand, the operational environment for cross-border SME activity has become increasingly challenging. According to the European Union Chamber of Commerce in China's Business Confidence Survey 2025, 73 percent of surveyed firms reported greater difficulty in doing business in China, reflecting intensifying competition, regulatory barriers, and geopolitical uncertainty [3]. Geopolitical tensions, including the continued suspension of the EU-China Comprehensive Agreement on Investment (CAI) and continuing trade frictions over electric vehicle tariffs, have introduced systemic risks that disproportionately affect SMEs with limited resources to navigate complex regulatory landscapes [4]. Simultaneously, European firms are reassessing supply chain exposure to China. Recent business surveys indicate that export controls, licensing delays, and strategic raw material risks have encouraged some European companies to explore alternative sourcing options and more diversified supply chain arrangements [5].

The central question motivating this inquiry is: How can SMEs strategically employ corporate diversification to enhance their performance and resilience within the complex China-Europe trade and investment integration framework, and what corporate management capabilities are required to successfully implement such diversification strategies? This question carries particular urgency because SMEs typically lack the resources, governance structures, and regulatory expertise that larger multinational corporations command. These governance limitations are closely related to SME innovation, internationalization, auditing, and risk of failure [6]. Yet SMEs face similar—if not greater—pressures to diversify in response to geopolitical and market uncertainties.

Recent literature have begun to explain parts of this problem. Studies on SME governance, regional diversification, and Mittelstand enterprises' exposure to international crises suggest that geopolitical tensions, internal governance deficiencies, and resource-access challenges are major barriers to diversification in cross-border contexts [6-8]. Effective governance, including regulatory monitoring, compliance auditing, agile management systems, and cross-functional coordination, is therefore important for SMEs seeking to diversify under China-Europe trade and investment conditions.

This paper aims to synthesize emerging empirical evidence to construct an integrated analytical framework explaining the mechanisms through which corporate diversification enhances SME performance under China-Europe trade integration, while identifying the corporate management capabilities required to realize diversification benefits. Drawing upon resource-based theory, transaction cost economics, and institutional theory, the analysis identifies three primary diversification pathways—product diversification, geographic market diversification, and supply chain diversification—each with distinct performance implications and management requirements.

## 2. Literature Review and Theoretical Foundations

### 2.1 Theoretical Perspectives on Corporate Diversification

Corporate diversification—the expansion of a firm's activities into new products, markets, or supply chain stages—has been extensively studied through multiple theoretical lenses. The resource-based view posits that diversification represents a strategy for leveraging excess productive resources, distinctive competencies, and intangible assets across multiple business domains. From this perspective, firms diversify when they possess resources that are valuable, rare, imperfectly imitable, and non-substitutable in their current deployment, and when these resources can be profitably applied to alternative uses without diminishing their value in original applications.

Transaction cost economics offers a complementary perspective, framing diversification decisions as responses to market failures in intermediate product markets. When external transactions for acquiring inputs, distributing outputs, or accessing markets entail prohibitively high search, negotiation, monitoring, or enforcement costs, firms may internalize these activities through vertical integration or horizontal expansion. The optimal diversification boundary is reached where the marginal costs of internal governance equal the marginal costs of market-based exchange.

Institutional theory provides an additional lens, emphasizing that diversification decisions are shaped not only by economic efficiency considerations but also by institutional pressures from regulatory bodies, industry associations, and social norms. Firms operating in environments with weak market-supporting institutions may diversify to compensate for institutional voids, internalizing functions that would otherwise be provided by third-party intermediaries in more developed institutional contexts.

For SMEs specifically, these theoretical perspectives must be adapted to account for the distinctive characteristics of smaller enterprises: resource constraints that limit the scope and pace of diversification, governance structures that concentrate decision-making authority in owner-managers, and liability of smallness that magnifies the risks of diversification failure.

Recent evidence further suggests that SME resource constraints are not limited to financial shortages. They also include limited digital infrastructure, weak managerial slack, insufficient technological readiness, and limited access to external knowledge. In resource-constrained environments, these limitations reduce SMEs' ability to adopt advanced technologies, monitor foreign regulatory changes, and coordinate diversified operations across products, markets, and supply chains. Therefore, SME diversification depends not only on market opportunities but also on whether firms possess the organizational and technological resources needed to absorb additional complexity [9].

## 2.2 Diversification and SME Performance: Empirical Evidence

The relationship between diversification and SME performance has generated substantial empirical inquiry, with findings that nuance the conventional wisdom regarding diversification benefits. Existing SME studies suggest that market development and diversification strategies may improve firm performance when they are supported by adequate resources, managerial capability, and market knowledge.

Although this evidence is drawn from the U.S. food and agriculture sector and should not be directly generalized to the China-Europe context, it provides useful comparative evidence that horizontal diversification can strengthen SME resilience under external shocks. Firms with higher levels of horizontal diversification were less likely to shut down, lay off employees, or experience labor shortages than horizontally specialized firms during the COVID-19 pandemic [10]. This finding provides compelling evidence that diversification serves as a resilience mechanism, buffering SMEs against exogenous disruptions that would otherwise threaten survival. Therefore, diversification should be understood as a potential resilience mechanism rather than a universally positive strategy.

However, the relationship between diversification and performance is not uniformly positive. A systematic literature review on corporate governance in SMEs found a direct relationship between governance mechanisms and various aspects of SME performance, including innovation, internationalization, auditing, and risk of failure, suggesting that the performance effects of diversification are mediated by the quality of governance structures [6]. SMEs with weak governance may experience diversification discount—the phenomenon where diversified firms trade at lower valuation multiples than focused firms—due to agency problems, coordination costs, and resource misallocation.

International evidence from cross-country SME samples indicates that SMEs experiencing a moderate degree of financial constraints use the most diversified sources of financing, while financially unconstrained SMEs use fewer financing sources [11]. This quadratic relationship suggests that diversification of financing sources by SMEs is a strategic choice based on optimal complementarity achieved through credit multiplier channels, rather than a desperate response to financial distress.

## 2.3 International Diversification and Geographic Expansion

For SMEs engaged in cross-border operations, international diversification—expansion into foreign geographic markets—carries distinctive implications. Research utilizing cross-country data from China and Poland demonstrates that non-predictive strategy (a core principle of effectuation theory) is positively associated with international diversity, and that affordable loss mediates the positive effect of non-predictive strategy on the international performance of SMEs [12]. This finding suggests that SMEs navigating uncertainty in international markets benefit from effectual logic that emphasizes control over prediction and focuses on limiting downside exposure rather than maximizing upside potential.

The effectuation perspective is particularly relevant for SMEs expanding into China and European markets, where uncertainty levels are elevated due to regulatory heterogeneity, cultural differences, and geopolitical volatility. Unlike large multinational corporations that can deploy predictive strategies based on extensive market intelligence and scenario planning, SMEs must rely on flexible, iterative approaches that allow them to adjust course as new information emerges.

Studies on SME regional diversification indicate that dynamic patterns of geographic expansion are shaped by home market institutional determinants [7]. SMEs from institutional environments characterized by regulatory complexity, political instability, or weak property rights protection may exhibit distinctive diversification patterns compared to SMEs from more stable institutional contexts. This has direct implications for Chinese SMEs expanding into Europe and European SMEs entering China, given the substantial institutional differences between the two economic systems.

## 2.4 Supply Chain Diversification and De-Risking

The contemporary discourse on SME diversification has been substantially shaped by supply chain vulnerabilities exposed during the COVID-19 pandemic and exacerbated by subsequent geopolitical tensions. The concept of “de-risking”—reducing strategic dependencies on single-source suppliers, particularly those located in geopolitically sensitive jurisdictions—has gained prominence in policy and business circles.

Research on German Mittelstand enterprises examines how international crises affect SMEs’ access to foreign markets and resources, highlighting the importance of diversified sourcing and market access strategies under external uncertainty [8]. Such exposure is particularly relevant in sectors where raw materials, components, or processing capacity are concentrated in China. Concentrated sourcing increases the vulnerability of SMEs when trade frictions, export controls, or logistics disruptions affect cross-border supply chains.

Recent business surveys suggest that European firms are reassessing supply chain exposure to China, especially in sectors affected by export controls, licensing delays, and strategic raw material risks. These pressures have encouraged some companies to explore alternative sourcing options and more diversified supply chain arrangements [5]. This trend is driven by multiple factors, including China’s push for production self-sufficiency, export controls that deepen global trade uncertainty, and firms’ need to build resilience against future disruptions.

For SMEs, the “China+1” strategy—maintaining operations in China while developing alternative sourcing or production capabilities in other countries—has become increasingly relevant as firms seek to reduce excessive dependence on a single production or sourcing location [5]. However, implementing such strategies requires substantial investment in supplier identification, relationship management, quality assurance, and logistics coordination—capabilities that many SMEs lack.

## 2.5 Corporate Governance in Diversified SMEs

The relationship between corporate governance and diversification success is critically important for SMEs. A systematic literature review examining corporate governance in SMEs identified five categories of governance characteristics: board, ownership, chief executive officer (CEO), audit, and age [6]. The review found a direct relationship between governance mechanisms and various aspects of SME performance, including innovation and internationalization, and highlighted the need for future research to adopt behavioral perspectives and use nonlinear models to analyze governance phenomena.

For diversified SMEs operating across the China-Europe trade corridor, governance challenges are amplified by geographic distance, regulatory heterogeneity, and cultural differences. Boards may lack the international expertise needed to oversee cross-border operations. Ownership structures that concentrate decision-making authority may create bottlenecks in responding to rapidly changing conditions in multiple markets. CEO capabilities in managing complexity across diverse business domains become critical success factors.

Ownership concentration may also shape diversification decisions in SMEs. In owner-managed firms, concentrated decision-making can accelerate strategic responses, but it may also weaken formal oversight and increase the risk of overextension when diversification decisions are not supported by adequate governance mechanisms. This finding has implications for Chinese SMEs with concentrated ownership structures expanding into European markets with stronger investor protection regimes, where governance expectations may differ substantially from home country norms.

## 2.6 ESG Integration and Sustainable Diversification

The integration of environmental, social, and governance (ESG) considerations into diversification strategies has emerged as a significant theme in contemporary SME research. Studies on the internal dynamics of SMEs suggest that organizational intellectual capital can support employee sustainable innovation behavior, which in turn contributes to ESG practice implementation and company performance [13].

For SMEs pursuing diversification under the China-Europe trade and investment integration framework, ESG alignment carries particular importance given the EU’s stringent sustainability requirements, including the Corporate Sustainability Reporting Directive (CSRD) and the European Sustainability Reporting Standards (ESRS). ESG disclosure and digital transformation can also reinforce sustainability-oriented innovation by improving resource allocation, process transparency, and managerial attention to environmental performance.

A finance-sector-led initiative has sought to improve impact disclosure and mobilize capital toward sustainable development, addressing an estimated US\$4.2 trillion annual financing gap for the UN Sustainable Development Goals [14]. For SMEs, this broader financing gap highlights the importance of ESG-linked finance, fintech-enabled lending, and diversified financing sources.

In this context, fintech-based financing and diversified financing sources have become important channels for SMEs facing obstacles in traditional bank credit markets. Digital lending platforms, supply-chain finance, crowdfunding, and ESG-linked financial products can reduce information asymmetry and provide SMEs with alternative access to capital. These mechanisms are especially relevant for diversified SMEs because product, market, and supply chain

diversification often require upfront investment before performance gains can be realized [11].

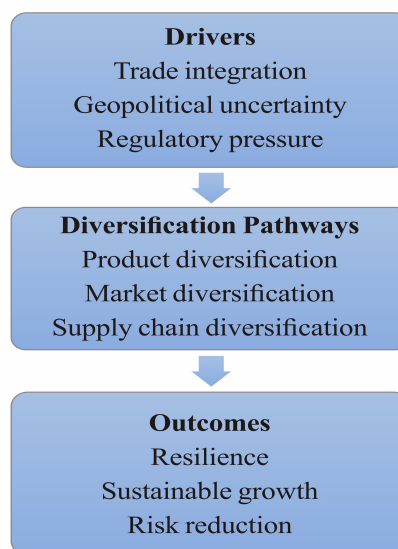
## 2.7 Methodological Note and TCCM-Based Review Logic

This study adopts a conceptual review and narrative synthesis approach rather than a full systematic literature review. The reviewed literature was organized around four bodies of work: SME diversification, China-Europe trade and investment integration, corporate governance and compliance, and ESG-oriented digital transformation. To improve the transparency of the review logic, this study also draws on the Theory, Context, Characteristics, and Methodology (TCCM) framework, which examines theory, context, characteristics, and methodology [15].

In terms of theory, the paper integrates the resource-based view, transaction cost economics, and institutional theory. In terms of context, it focuses on SMEs operating under China-Europe trade and investment integration. In terms of characteristics, it examines product diversification, geographic market diversification, supply chain diversification, governance capability, ESG integration, and digital capability building. In terms of methodology, it synthesizes recent empirical findings, policy reports, and conceptual studies to identify research gaps and build an integrated analytical framework. This approach is appropriate because the purpose of the paper is not to test a statistical model, but to clarify the mechanisms through which diversification and corporate management capabilities jointly shape SME resilience and sustainable growth.

## 3. Analytical Framework: Diversification Pathways for SMEs under China-Europe Trade Integration

Based on the theoretical foundations and empirical evidence reviewed above, this paper proposes an integrated analytical framework identifying three primary diversification pathways for SMEs engaged in or seeking to engage in China-Europe trade and investment: product diversification, geographic market diversification, and supply chain diversification. Figure 1 presents the integrated conceptual framework developed in this study. It links external drivers, diversification pathways, corporate management capabilities, and expected outcomes.



**Figure 1.** Conceptual framework of SME diversification under China-Europe trade integration.

### 3.1 Pathway 1: Product Diversification

Product diversification involves expanding the range of products or services offered to existing or new markets. For SMEs operating in the China-Europe trade corridor, product diversification can serve multiple strategic objectives: reducing dependence on single product lines vulnerable to tariff fluctuations or demand shifts; capturing cross-selling opportunities by offering complementary products to existing customers; and leveraging production capabilities across multiple product categories to achieve economies of scope.

Empirical evidence indicates that SMEs with higher levels of horizontal diversification demonstrate greater resilience during market shocks, with lower probabilities of shutdown, layoffs, and labor shortages [10]. However, product diversification also increases organizational complexity, requiring enhanced coordination capabilities and potentially diluting focus on core competencies.

For Chinese SMEs exporting to Europe, product diversification may involve upgrading from low-margin commodity products to higher-value manufactured goods with greater differentiation and brand recognition. For European SMEs entering China, product diversification may require adaptation of product offerings to local preferences, regulatory requirements, and distribution channels—a process that demands substantial investment in market intelligence and product development.

### 3.2 Pathway 2: Geographic Market Diversification

Geographic market diversification involves expanding into new geographic markets beyond home country operations. For SMEs in both China and Europe, geographic diversification within the China-Europe trade corridor can reduce dependence on single markets vulnerable to trade policy changes, economic fluctuations, or demand shifts.

Evidence from cross-country SME samples demonstrates that non-predictive strategy—emphasizing control over uncertainty rather than prediction—is positively associated with international diversity, and that affordable loss mediates the effect on international performance [12]. This suggests that SMEs should approach geographic diversification through effectual logic, limiting initial investment to levels that would not threaten firm survival if markets fail to develop as anticipated.

The China-Europe trade corridor offers multiple geographic diversification opportunities. Central and Eastern European countries have become relevant locations for Chinese firms seeking European market access, especially in sectors where trade, investment, and regional industrial linkages overlap [16]. For European SMEs, China continues to offer market opportunities, with 55 percent of surveyed European SMEs identifying China as the Asia-Pacific market offering the best opportunities for growth [2].

### 3.3 Pathway 3: Supply Chain Diversification

Supply chain diversification involves expanding the network of suppliers, manufacturing locations, or distribution channels to reduce dependence on single sources or geographic concentrations. In the context of China-Europe trade, supply chain diversification has become a strategic imperative driven by geopolitical tensions, trade policy uncertainty, and the lessons of pandemic-induced disruptions.

European firms are reassessing supply chain exposure to China, and recent business surveys indicate that export controls, licensing delays, and strategic raw material risks have encouraged some firms to explore alternative sourcing options and more diversified supply chain arrangements. For SMEs, the “China+1” strategy—maintaining operations in China while developing alternative sourcing or production capabilities in other countries—has become increasingly relevant as firms seek to reduce excessive dependence on a single production or sourcing location [5].

For Chinese SMEs, supply chain diversification may involve establishing warehousing and distribution capabilities within Europe to reduce dependence on cross-border logistics vulnerable to customs delays and regulatory changes. For European SMEs, diversification may involve developing supplier relationships in Association of Southeast Asian Nations (ASEAN) countries, Central and Eastern Europe, or other regions as alternatives to exclusive China sourcing.

The implementation of supply chain diversification requires substantial investment in supplier identification, relationship management, quality assurance systems, and logistics coordination—capabilities that many SMEs often lack. However, digital technologies, including cloud-based supplier management platforms and artificial intelligence (AI)-enhanced logistics optimization, may reduce the transaction costs of diversification, making it more accessible to resource-constrained SMEs.

## 4. Performance Implications of SME Diversification

### 4.1 Resilience Benefits

The most robust finding from recent empirical research is that diversification significantly enhances SME resilience to exogenous shocks. Comparative evidence from the U.S. food and agriculture sector during the COVID-19 pandemic shows that diversified firms were less likely to shut down, lay off employees, or experience labor shortages than horizontally specialized firms [10]. Although this evidence comes from outside the China-Europe context, it helps illustrate the general resilience mechanism through which diversification spreads risk across products, markets, and operational activities.

This resilience benefit operates through multiple mechanisms. First, diversification spreads risk across multiple product lines, customer segments, or geographic markets, reducing the impact of demand fluctuations in any single domain. Second, diversified firms can reallocate resources from contracting to expanding activities, maintaining capacity utilization and employment. Third, diversification generates option value—the ability to scale up activities in promising areas without building capabilities from scratch when opportunities materialize. Empirical evidence from Chinese manufacturing firms confirms that enterprises participating in both domestic and foreign markets achieve higher sales growth during industry downturns compared to single-market enterprises, particularly in concentrated industries and non-state-owned firms [17].

For SMEs operating in the China-Europe trade corridor, where geopolitical tensions and trade policy uncertainty create periodic disruptions, this resilience benefit carries substantial value. SMEs that have diversified across product categories or geographic markets are better positioned to withstand tariff increases, regulatory changes, or demand shifts that disproportionately affect undiversified competitors.

## 4.2 Performance Heterogeneity

The performance effects of diversification are not uniform across all SMEs or all diversification types. Evidence indicates that the relationship between diversification and performance is moderated by multiple factors, including governance quality, resource availability, and strategic alignment.

International evidence shows that SMEs experiencing moderate financial constraints use the most diversified sources of financing, suggesting that diversification is a strategic choice based on optimal complementarity rather than a universal prescription [11]. SMEs should calibrate diversification scope to their financial capabilities, avoiding over-diversification that may strain limited resources and generate coordination costs that exceed benefits.

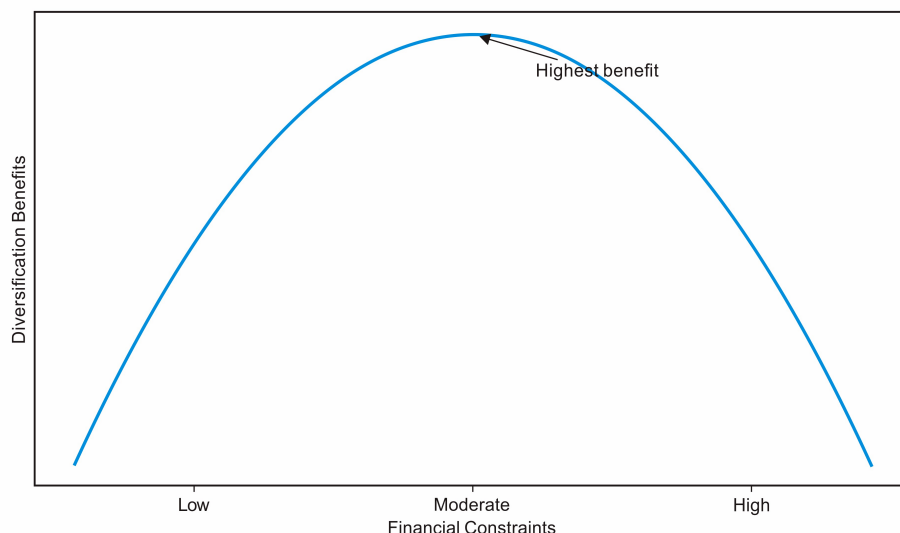
External geopolitical shocks may further reshape this relationship by tightening SME financing conditions. Events such as investment agreement uncertainty, tariff disputes, export controls, and geopolitical realignment can increase lenders' perception of risk. For export-oriented SMEs, these shocks may weaken expected cash flows, reduce collateral value, and raise the cost of external finance. Because SMEs usually have shorter credit histories and fewer tangible assets than large firms, banks may respond to uncertainty by tightening lending standards or reducing exposure to cross-border borrowers. As a result, geopolitical shocks can restrict the credit multiplier channels through which SMEs finance diversification.

Research on the relationship between ESG practices and SME performance suggests that ESG-oriented practices can support sustainable innovation and firm performance, although these effects may depend on digital capability and managerial perception [13]. For diversified SMEs, the ability to implement ESG practices across multiple business units—and to report ESG performance coherently—becomes an important determinant of whether diversification generates performance improvements or complications.

## 4.3 Curvilinear Relationships

Emerging evidence suggests that the relationship between diversification and SME performance may follow curvilinear rather than linear patterns. Studies on financing source diversification identified a quadratic relationship between financial constraints and diversification, with SMEs experiencing moderate constraints using the most diversified sources [11]. This inverted U-shaped pattern suggests that diversification benefits initially increase with scope but eventually diminish—and may even become negative—beyond an optimal point.

Figure 2 illustrates this inverted U-shaped logic. At low levels of financial constraint, SMEs may lack sufficient pressure to diversify financing sources or business activities. At moderate levels, diversification can improve resilience and strategic flexibility. However, when financial constraints become severe, the costs of coordination, compliance, and external financing may outweigh the benefits of diversification.



**Figure 2.** Inverted U-shaped relationship between financial constraints and diversification benefits.

This logic is also consistent with recent evidence that trade policy uncertainty can generate nonlinear effects on firm-level strategic outcomes, including ESG performance. Moderate uncertainty may encourage adaptive responses, whereas excessive policy volatility can restrict investment capacity [18].

For product diversification, the optimal scope depends on the firm's coordination capabilities, market conditions, and competitive positioning. For geographic diversification, the optimal number of markets depends on the firm's ability to manage cultural and regulatory heterogeneity across jurisdictions. For supply chain diversification, the optimal number of suppliers depends on the trade-off between resilience benefits and coordination costs.

For SMEs under the China-Europe trade integration framework, identifying the optimal diversification scope requires

careful analysis of firm-specific capabilities, market conditions, and risk exposures. Rather than pursuing diversification for its own sake, SMEs should adopt a strategic approach that aligns diversification scope with their distinctive resources and governance capabilities.

## **5. Corporate Management Challenges and Capability Requirements**

### **5.1 Governance and Compliance Management**

The most significant challenge facing SMEs pursuing diversification under China-Europe trade integration is governance and compliance management. Existing research suggests that geopolitical tensions, internal governance deficiencies, and team management challenges constitute important hurdles for SMEs engaging in diversification across cross-border economic spaces [6,7].

A practical response is to develop agile compliance monitoring systems. For SMEs with limited resources, this may involve external legal support, periodic regulatory compliance audits, agile management routines, and simple compliance monitoring dashboards. For SMEs with limited resources to maintain dedicated legal and compliance departments, these systems can be implemented through shared service arrangements, outsourcing to specialized providers, or technology platforms that automate compliance monitoring.

The regulatory environment for China-Europe trade is complex and evolving. The EU-China CAI, while agreed in principle in 2020, has remained suspended since 2021 due to diplomatic tensions. Its uncertain status continues to complicate long-term investment planning for SMEs. However, even without a formal investment agreement, trade between China and the EU continues to grow, with bilateral trade reaching approximately US\$780 billion in 2025 [1].

SMEs must navigate heterogeneous regulatory environments across European jurisdictions. While the EU provides a common regulatory framework for many areas, significant differences remain among member states in areas such as labor law, tax policy, and environmental standards. SMEs expanding into multiple European markets face compliance burdens that larger firms can absorb through dedicated staff but that may strain SME resources.

### **5.2 ESG Integration and Sustainability Compliance**

The integration of ESG considerations into corporate management has become increasingly important for SMEs seeking access to European markets. The EU has implemented stringent sustainability requirements, including the CSRD, which imposes mandatory ESG disclosure obligations on a broad range of companies, including many SMEs.

Research on SME sustainability suggests that ESG-oriented practices can support sustainable innovation and company performance, while digital capability may strengthen this process through improved coordination and resource allocation [13]. For SMEs pursuing diversification into European markets, the ability to implement ESG practices across diversified operations—and to report ESG performance in accordance with European standards—is becoming a competitive necessity rather than a discretionary choice. Extending this logic, recent evidence from emerging Asian economies suggests a sequential mechanism through which digital capabilities support SME sustainable export competitiveness. First, digital capabilities improve information processing, partner coordination, and market responsiveness. Second, these capabilities facilitate sharing economy practices, such as resource sharing, platform-based collaboration, and flexible access to external capabilities. Third, sharing economy practices strengthen ESG engagement by improving coordination efficiency and stakeholder legitimacy. Through this sequence, diversification is not only a defensive response to uncertainty but also a sustainable route toward export competitiveness [19].

The European Financial Reporting Advisory Group (EFRAG) submitted simplified ESRS recommendations in December 2025, based on an Omnibus simplification mandate that streamlined sustainability reporting requirements [20]. This simplification reduces the compliance burden for SMEs, making ESG integration more accessible to smaller enterprises.

### **5.3 Digital Transformation and Capability Building**

Digital transformation has emerged as a critical enabler of SME diversification success. Research demonstrates that digital capabilities can strengthen the link between ESG engagement, innovation, and sustainable export competitiveness by improving resource allocation and process efficiency [19]. For diversified SMEs, digital technologies can reduce the transaction costs of managing multiple business units, geographic locations, or supply chain relationships.

Cloud-based enterprise resource planning (ERP) systems enable real-time visibility across diversified operations, facilitating coordination and control. AI-powered analytics support market intelligence and opportunity identification for geographic expansion. Blockchain-based supply chain platforms enhance traceability and trust across multi-tier supplier networks.

Virtual platforms, including metaverse-based environments, can also support SME diversification by enabling digital

exploration before physical market entry. Through virtual showrooms, immersive product demonstrations, and online buyer-seller interaction spaces, SMEs can test consumer responses, build brand visibility, and identify potential partners without immediately bearing the full costs of customs procedures, overseas offices, or physical distribution networks. In this sense, virtual market exploration can function as a low-cost preparatory stage before geographic market diversification or supply chain diversification [21].

However, digital transformation requires substantial investment in technology infrastructure, staff training, and process redesign—investments that many SMEs struggle to fund. Therefore, the integration of digital capabilities with governance routines, financing support, and ESG engagement is essential for transforming diversification from a reactive survival tactic into a sustainable growth strategy.

#### 5.4 Human Capital and Leadership Development

The successful implementation of diversification strategies requires human capital capabilities that many SMEs lack. The systematic literature review on corporate governance in SMEs identified CEO capabilities and team management as critical governance mechanisms affecting SME performance [6].

For SMEs pursuing diversification under China-Europe trade integration, leaders must possess capabilities in multiple domains: international business strategy, cross-cultural management, regulatory compliance, and risk management. These capabilities are often concentrated in the owner-manager in SMEs, creating key-person risk. Developing leadership depth through management team building and succession planning is essential for sustaining diversification success.

Team management challenges include coordination across geographically dispersed units, communication across language and cultural barriers, and motivation alignment when team members operate under different legal and compensation regimes. Addressing these challenges requires investment in cross-cultural training, communication technologies, and performance management systems that account for geographic and cultural differences. These challenges are particularly serious for geographically dispersed SMEs because they often lack formal coordination routines and specialized human resource departments. When production, sales, compliance, and supplier management teams are located in different countries, managers must coordinate across time zones, languages, institutional expectations, and work cultures. Without clear reporting lines, shared digital communication routines, and locally informed decision-making authority, diversification may increase internal friction rather than improve resilience.

### 6. Policy Implications

The findings of this study offer several actionable implications for policymakers in both China and the EU.

First, reducing uncertainty around the EU-China investment framework would lower transaction costs for SME cross-border investment. Although the EU-China CAI has remained suspended since 2021, clearer rules on market access, sustainability, digital trade, and dispute resolution would help SMEs make more stable long-term investment decisions.

Second, simplifying sustainability reporting requirements for SMEs—as pursued through the EFRAG Omnibus simplification process—can reduce compliance burdens and make ESG integration more accessible [20]. Further simplification and harmonization across EU member states would benefit SMEs operating in multiple European jurisdictions.

Third, expanding funding mechanisms that target SME diversification capabilities is essential. The broader sustainable development financing gap requires coordinated action from multilateral development banks, national development finance institutions, and private investors [14]. SME-specific ESG-linked finance products, capacity-building programs, and standardized disclosure frameworks tailored to SME needs would accelerate sustainable diversification. These mechanisms may include public credit guarantee schemes, supply-chain finance, fintech-enabled lending platforms, export credit insurance, sustainability-linked loans, and SME-oriented green transition funds. Such instruments can reduce the financing constraints that prevent SMEs from investing in new products, alternative suppliers, digital platforms, and overseas market entry.

Fourth, prioritizing digital infrastructure that reduces diversification transaction costs—including cross-border data flows, interoperable digital identity systems, shared compliance platforms, and digital trade services—can help SMEs manage diversified operations more efficiently.

### 7. Limitations and Future Research Directions

This study has several limitations that can guide future research. First, the discussion is limited to SMEs in the context of China-Europe trade and investment integration. The findings may therefore not apply directly to other regional settings, such as ASEAN, Africa, Latin America, or other developing economies, where regulatory systems and geopolitical conditions may differ.

Second, this paper is a conceptual review rather than an empirical study. It does not test the proposed framework with firm-level data, survey results, or econometric models. Future research could use longitudinal data or cross-country samples to examine how diversification, governance capability, financial constraints, ESG integration, and SME performance interact over time.

Third, the framework focuses on three main diversification pathways: product diversification, geographic market diversification, and supply chain diversification. Other forms of diversification, such as digital diversification, business model diversification, and financial diversification, may also influence SME resilience. These areas deserve closer attention in future studies.

Fourth, the effects of diversification are likely to differ across firms. Firm size, sector, ownership structure, digital maturity, and managerial capability may all shape whether diversification improves resilience or creates additional coordination costs. Future studies could further clarify the conditions under which diversification benefits SMEs and the conditions under which it becomes a burden.

## 8. Conclusion

This paper has examined the strategic relationship between corporate diversification and corporate management practices of SMEs within the evolving context of China-Europe trade and investment integration. Synthesizing recent empirical evidence, the analysis identifies three primary diversification pathways: product diversification, geographic market diversification, and supply chain diversification. Each pathway offers distinctive resilience benefits and performance implications, but also imposes specific management requirements that SMEs must address to realize diversification success.

The evidence demonstrates that diversification significantly enhances SME resilience during market disruptions, with horizontally diversified firms showing lower failure rates under exogenous shocks. However, the relationship between diversification and performance is moderated by multiple factors, including governance quality, resource availability, and strategic alignment. For SMEs operating under the China-Europe trade integration framework, the optimal diversification scope requires careful calibration to firm-specific capabilities and market conditions.

The primary challenges facing SMEs in pursuing diversification are governance and compliance management, ESG integration, digital capability building, and human capital development. Addressing these challenges requires investment in agile compliance monitoring systems, ESG reporting infrastructure, digital technologies, and leadership development—investments that many SMEs struggle to fund but that are essential for diversification success.

The integration of China and European economies, reflected in approximately US\$780 billion in bilateral trade in 2025, creates important opportunities and challenges for SMEs on both continents [1]. SMEs that navigate this complex environment through strategic diversification and stronger corporate management capabilities are more likely to capture growth opportunities and build resilience against future disruptions. By contrast, SMEs that lack these capabilities may face greater difficulty in responding to regulatory uncertainty, financing constraints, and supply chain risks.

## Conflict of Interest

The author declares no conflict of interest.

## Generative AI statement

The author declares that no Gen AI was used in the creation of this manuscript.

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