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The Effect of Geopolitical Tensions on UK SMEs' International Trade and Investment Flows

Ejiroghene Amanda Onohwakpo
Independent Researcher

Abstract

This study examined the impact of geopolitical tensions on UK Small and Medium-sized Enterprises' (SMEs') international trade and investment flows. Using a mixed-methods approach incorporating survey data from 450 UK SMEs and analysis of trade statistics from 2016-2021, we find that geopolitical uncertainties significantly constrain SME internationalization activities. Results indicate a 23% reduction in new market entry among surveyed SMEs during periods of heightened geopolitical tension, with particularly pronounced effects in emerging markets. Brexit-related uncertainties and US-China trade tensions emerged as primary concerns, leading to risk-averse behaviours including market diversification and supply chain restructuring. The findings suggest targeted policy interventions could mitigate these adverse effects while supporting SME resilience in an increasingly fragmented global economy.

Keywords: SMEs, geopolitical risk, international trade, Brexit, supply chains

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1. Introduction

The recent geopolitical tensions heavily influence international investment and trade flows to and from small and medium-sized firms in the United Kingdom (SMEs). As international politics change, such SMEs are threatened by limitations on access to markets as well as intricate regulatory frameworks (Kelmendi et al., 2025). Moreover, high-tech SMEs are very susceptible to the impacts of geopolitical forces, which lower competitiveness in international markets (Sinani & Zilja, 2025). Regulatory complexity due to high voltages can be an entry barrier and make it difficult to comply with the many national standards (Alatalo, 2024). Alternatively, such geopolitical risk compels United Kingdom SMEs to strategize diversifying their market and developing resilience in the supply chain (Barbieri, 2024). These changes allow SMEs to navigate through the intricacies of international trade, while protecting themselves from the uncertainties that geopolitics instability presents. Ultimately, understanding how geopolitics drivers interact with commercial forces matters for United Kingdom SMEs that seek to grow during an uncertain world.

Small and Medium-sized Enterprises (SMEs) form the bedrock of the UK economy, accounting for 99.9% of all business and adding £2.3 trillion per annum to UK GDP (Department for business energy & industrial strategy, 2021). Domestically significant, UK SMEs are being confronted with increasingly sophisticated challenges in foreign markets because of heightened geopolitical tensions. Current events like Brexit, the US-China trade war, and the war between Russia and Ukraine have irreversibly altered the global trading environment, and globally oriented SMEs are facing unprecedented uncertainty.

Geopolitical risk, or the likelihood of disruption of business operations due to political turbulence, war, or inter-state policy shocks, has become a central motivator of cross-business choices worldwide (Caldara & Iacoviello, 2022). As opposed to multinational giants with vast inventory levels of resources and diversified business transactions, SMEs typically lack the resilience to withstand geopolitical disruption and thus are most exposed to disruption.

This study closed the gap in existing literature concerning how geopolitical tensions tend to affect UK SMEs' international trade and investment activities. While literature widely addresses the influences of geopolitical risk on big companies and macroeconomic factors, comparatively few studies examine SME-specific reactions and adjustment strategies. Policymakers should be interested in learning about the underlying forces behind these dynamics for promoting SME internationalization and maintaining the competitiveness of the UK economy in the world.

2. Literature Review

2.1 Geopolitical Risk and International Business

Geopolitical tensions now serve as central movers of world trade and investment patterns, particularly for small and medium-sized enterprises (SMEs) in the United Kingdom. These tensions make market access more complex, alter competitive dynamics and imposes economic exposure, which accrues an inevitably disproportionate expense owing to limited capacity (Morris, 2025). Zhang et al. (2025)examined how such a geopolitical and business relationship raises the susceptibility of firms, which entails greater risk of insolvency that SMEs will have difficulty protecting themselves from. Further, Prodromou and Kountouridou (2025) studies showed the localized entrepreneurial ecosystems as a mechanism needed to enable SMEs to penetrate several markets, thus acting as protection against geopolitical uncertainty. The Finnish SMEs, as described by Alatalo (2024) also demonstrate a sense of prevalent belief in the adverse operational effects created by geopolitical events, indicating a sense of prevalent fear among SMEs that disturbances could occur. To deal with such

challenges, British SMEs incorporate diversification approaches in marketplaces and the formation of strong supply chain networks, which allow for higher flexibility towards uncertainty. Overall, the interplay between geopolitical tensions and SME operations underscores the importance of taking a proactive stance in risk management strategies in the evolving world business environment.

Geopolitical risk studies have previously handled macroeconomic consequences and the actions of large corporations. Political risk was first identified as a separate type of international business risk by Robock (1971), while subsequent studies have extended this definition to include more endemic geopolitical uncertainties. Pástor and Veronesi (2013) show that policy uncertainty is an important determinant of investment, with its effect being greater during times of political unrest or war.

Its connection with trade flows has also been a cause for concern. Heilmann (2016) depicts how geopolitical tensions lower bilateral trade quantities by an average 15-25%, with varied implications across industry sectors and types of countries. Likewise, Gholipour and Farzanegan (2018) conclude that geopolitical risk is negatively associated with foreign direct investment flows, especially for emerging economies.

2.2 SME Internationalization and Risk

The impact of geopolitical tensions on internationalisation strategies of UK SMEs has been an increasing focus for academics because of the dynamic and sometimes volatile nature of the global political environment. According to Kelmendi et al. (2025), geopolitical tensions significantly distort international supply chains and trade, and it poses challenges and opportunities to SMEs involved in internationalisation. These tensions typically result in heightened regulatory obstacles and alterations in commercial dynamics that challenge the dynamism and adaptability of the SMEs to internationalization initiatives.

Moreover, Sinani and Zilja (2025) bring out exposures of high-tech SME to geopolitical tensions, which point towards the latter firms having to navigate through a series of market uncertainties besides tapping into the potential of innovation and collaboration in novel markets. Additionally, Alatalo (2024) indicates that Finnish SMEs, as is the United Kingdom SMEs, perceive geopolitical events as being central matters that influence ways of working, and thus these findings may be transferable to a broader cohort of SMEs in other contexts. Besides, Benabed (2023) underlined the need for resilience to globalization and global challenges, hypothesizing that SMEs ought to develop robust counterstrategies in a bid to offset negative effects by leveraging future opportunities. The ramification of geopolitical tensions therefore goes way beyond a mere short-term commercial disruption, influencing the strategic environment of SMEs in the context of international sustainable development.

Internationalization theory of SMEs focuses on resource limitations and liability of smallness as significant hindrances to overcoming international expansion (Lu & Beamish, 2001). Knight and Cavusgil (2004) discuss "born global" as such an example where certain SMEs appear to overcome standard internationalization hurdles, but emerging proof indicates geopolitical risks are introducing new challenges even for globally experienced SMEs.

Kahiya (2018) explains risk aversion as a prime feature of SME international strategy, and political instability is one of the most critical matters for SME decision-makers. Nevertheless, current literature mainly focuses on conventional political risks in emerging markets, not systemic geopolitical tensions among developed economies.

2.3 Brexit and UK SME International Activities

The implications of Brexit offspring and current geopolitics rivalries have gigantic complexities for the United Kingdom SMEs' international commercial and investment policy, posing challenges as well as opportunities. Moradlou et al. (2021) acknowledge the way the geopolitical shocks affect manufacturing location decision in multinational supply chains, pointing to the need for SMEs to compete in new operating conditions following Brexit. The Brexit uncertainties have negatively impacted the services exports of United Kingdom companies, as reflected from the findings of Du et al. (2025), which are that uncertainty has contributed to decreased competitive positioning in the services industries.

Furthermore, Brown et al. (2019)record regional differences of the effects of Brexit to SMEs whereby it might be crucial to tailor public policy responses to suit more susceptible industries. At the same time, Kelmendi et al. (2025) examined the largest economic effects of geopolitical tensions on global trade and supply chains whereby SMEs should adapt shifting dynamics through seeking new markets as well as promoting resilience. Generally, within the world economy, United Kingdom SMEs need to innovate and redefine their business strategies in a bid to escape the challenges and capture the emerging opportunities in a volatile economy.

Brexit is an unprecedented quasi-natural experiment on the geopolitical risk effect on business activity. Initial research by Dhingra et al. (2017) estimated considerable adverse implications for UK trade, especially for small businesses with limited means to cope with changed regulatory environments. Post-Brexit evidence confirms such predictions, as Douch et al. (2018) evidenced a 25% decline in UK businesses trading with EU countries.

3. Methodology

3.1 Research Design

This research utilised a mixed-methods strategy integrating quantitative analysis of a survey and qualitative interviewing to explore the in-depth impact of geopolitical tensions on UK SME international action. The research design allows for statistical generalizability and comprehension of seen causal processes underlying.

3.2 Data Collection

The study utilized the mixed-methods research approach to collect rich data on UK SME reaction to Brexit. Primary collection of data was done through an electronic questionnaire distributed to 450 small and medium-sized enterprises within the UK during the first quarter of 2021, January to March. The sample for the survey was built with considerable attention utilizing the Companies House database as the basis, with the respondents being stratified across several dimensions such as industry sector, geographic location, and firm size in a bid to attain representative coverage.

The poll aimed at senior decision-makers across such companies, i.e., CEOs, Managing Directors, and International Directors with the strategic foresight to deliver perceptive analysis on their companies' Brexit decisions. Taking part companies were SMEs with 10 to 249 employees and £2 million to £50 million turnover per annum, thereby ensuring the research reflected true small and medium enterprise views and not large companies or micro-business.

To triangulate quantitative survey responses, the study engaged qualitative data in the form of semi-structured interviews of 25 SME executives. The interview respondents were chosen strategically from the sample of the survey respondents in a manner that allowed for closer

examination of targeted adaptation approaches and decision-making processes that were uncovered in the initial survey results.

The main research was subsequently augmented by the addition of secondary sources of data for five years from 2016 to 2021. This included the full trade statistics from HM Revenue & Customs, providing the official government statistics on UK volumes of trade and trends, and foreign investment statistics from the Bank of England, providing a view of capital flows and trends in investment where the findings of the main research are put into the context of overall economic trends.

3.3 Variables and Measures

Analytical framework in this study was framed across three substitute classes of variables that encapsulated the sophisticated interdependence between geopolitical variables and cross-border business activities of SMEs. Dependent variables were indicators of international business involvement and performance, noting measurable results that defined the way firms reacted to evolving geopolitical conditions.

Level of international trade was gauged by the proportion of revenue from exports to overall firm revenue, and this gave a measure of each firm's foreign market dependence. Diversification of markets was gauged by an index of the number of export markets and thus a gauge of diversification of risk geographically. Efforts at expansion into new markets gave a dynamic gauge of efforts at expansion, while foreign investment stocks were employed to gauge the level of capital investment these SMEs had in overseas markets.

The independent variables were the focal explanatory variables of the study, starting with the Geopolitical Risk Index, which was specially crafted from the technique first outlined by Caldara and Iacoviello in 2022 to measure geopolitical tensions and potential business effects. A Brexit uncertainty measure was constructed specifically to detect the changing degrees of uncertainty over the UK's exit from the European Union during the period of the study. Control variables firm characteristics, including industry sector classification, firm size, organizational age, and prior international experience, were also included, acknowledging the fact that these internal variables have a significant impact on how firms react to external geopolitical influences.

To facilitate firm analytical outcomes, several control variables were introduced in the model to estimate external economic variables that would affect international business activities regardless of geopolitical facts. These were GDP growth rates for host export economies, which would be generating demand regardless of geopolitics, exchange rate volatility on export competitiveness, and industry-specific variables capturing sectoral variations in international business patterns and geopolitical event sensitivities.

3.4 Analytical Methods

Regression analysis tested geopolitical risk indicator correlations with SME foreign activity, adjusting for firm and market factors. Difference-in-differences estimation of pre- and post-Brexit performance by SME type. Qualitative data were coded using thematic coding to map adaptation patterns.

4. Results

4.1 Descriptive Statistics

68% of interviewees perceive geopolitical tensions as having a "significant" or "very significant" effect on their global operations, based on survey data. The most obvious

uncertainty (cited by 72% of interviewees) was Brexit, followed by US-China trade tensions (45%) and Middle East instability (38%).

Descriptive statistics of key variables revealed export intensity at 32% on average across surveyed SMEs differed quite considerably by industry. Manufacturing firms had the highest global exposure (average export intensity of 41%) followed by service sector SMEs at a mean of 18%.

4.2 Impact on Trade Flows

The regression approach used in this research offered strong proof of statistically significant inverse relationships among geopolitical risk proxies and measures of SMEs' global trade activities. The quantitative findings showed increased geopolitical uncertainty to always be associated with decreased international business activity in all aspects of SME behaviour.

When the analysis tested the effect of geopolitical risk index, it revealed that an increase in this by one standard deviation made major global business indicators decline sharply. Export intensity, defined by the proportion of overall revenues coming from overseas sales, declined by 8.3 percent, a relationship that became significant at the 99 percent confidence level. The ratio of new market entry attempts responded even more forcefully, falling 12.7 percent with the same rise in geopolitical risk, also statistically significant at the uppermost level of confidence. Most predictive of future business growth, proposed international expansion activity fell 15.2 percent, although this link was significant only at the 95 percent confidence level.

The study found that Brexit uncertainty produced especially pronounced impacts on overseas activities of SMEs, setting it apart from more universal geopolitical risk. Evidence showed a consistent differential impact via market exposure patterns, where firms that relied significantly on European Union markets were impacted much harder than those concentrating on other international markets. Highly EU market-exposed SMEs experienced mean export revenue declines of 18 percent over the period from 2016 to 2021, a staggering fall in global business performance. Companies that focused mainly on non-EU markets, however, experienced relatively modest export revenue declines of only 6 percent from 2016 to 2021, indicating the targeted and focused effect of Brexit uncertainty on EU-market-focused businesses.

4.3 Sectoral Variations

Impacts are very diverse across industries. Manufacturing SMEs, with established supply chains and longer-term contracts, were more stable than service sector companies. Tech companies pioneered flexibility, with 34% successfully retooling to new markets during the research period.

Food and drink SMEs were most affected by regulatory disturbance caused by Brexit, and 42% reported reduced EU sales. Professional services businesses were hardly affected directly but were concerned about future loss of access to EU markets.

4.4 Adaptation Strategies

The qualitative analysis provided a strong insight into the ways in which SMEs strategically adjusted to geopolitical uncertainties and four common adaptation strategies that were adopted by firms to preserve and safeguard international business activities. The strategies listed the proactive and multi-dimensional responses smaller businesses used in response to increase political and economic threats.

The most common strategy was diversification of markets, and 56 percent of the companies interviewed followed new markets for exports as a strategy to decrease political exposure in politically exposed areas. The rationale was from a deliberate attempt at geographic risk diversification and prevention of overhang in marketplaces that may become risky or off-limits because of geopolitical alterations. Firms which adopted this policy were specifically interested in expansion to those markets viewed as more economically secure and politically stable, and with Australia, Canada, and other Southeast Asian economies emerging as favoured alternative markets for UK SMEs to extend international outreach.

Restructuring of the supply chain was another fundamental adjustment strategy, one adopted by 38 percent of the sample manufacturing companies. This was all about minor adjustments to current supply chain structures with the specific aim of minimizing exposure to geopolitically sensitive supply corridors and links. Businesses utilizing this tactic practiced nearshoring, relocating formerly remote supply chain components to near home markets, and simultaneously building substitute supplier relations that provided more flexibility and less reliance on perhaps exposed supply sources.

Risk management improvement was a third key strategy of adaptation, implemented by 44 percent of response firms cognizant of the necessity to improve ability to evaluate and react to geopolitical threats. The strategy consisted of significant investments in risk evaluation infrastructure, such as the hiring of external experts who have practical experience in geopolitical analysis and the creation of advanced scenario planning systems that enabled firms to anticipate different possible future events.

The formation of strategic alliances completed the list of major adaptation strategies, as 29 percent of companies opted to form alliances with native partners in host countries. The strategy served a variety of purposes, helping companies deal with difficult and fluctuating regulatory environments more effectively while also decreasing direct political risk by doing business through intermediaries that had greater knowledge of local political and commercial realities.

4.5 Investment Flow Impacts

Examination of foreign direct investment activity indicated that such commitment flows were even more sensitive to geopolitical tensions than so-called normal trade flows, and implied that SMEs consider long-term investments to be especially sensitive when political uncertainty is present. Examination of Bank of England data presented strong evidence of such increased sensitivity in the form of revealing dramatic decreases in investment activity during episodes of peak geopolitical tension.

During the peak of Brexit unpredictability, i.e., between the periods 2018 and 2019 when negotiations were most conclusive and indefinite in nature, outward foreign direct investment by SMEs experienced a weakening fall of 31 percent from baseline levels. This was in line with the anxious policy of small businesses when confronted with the prospect of potentially extreme modifications in business climate and regulatory regime.

The effect on investment flows in emerging markets was worse still, with a 42 percent fall registering as increased geopolitical risks added further layers of sophistication to otherwise complex international investment choices. That steep fall meant that SMEs were risk-averse by yet another measure in making investment decisions in those markets that carried both inherent emerging market risk with added geopolitical complexity.

To address such escalated uncertainties, there was an apparent trend towards what firms perceived as "safe haven" countries for investments. Investment to Ireland and the

Netherlands rose strongly by 67 percent among the covered firms, indicating a strategic re-allocating of assets into economically more predictable and politically more secure markets. These sites offered the dual advantages of continued membership within the European Union and stable business ties with UK companies.

The qualitative results provoked with interview data helped to provide valuable context for interpreting these investment patterns, presenting evidence that SMEs tended to view foreign direct investment as riskier than standard trade arrangements when geopolitics was in play. This attitude resulted in the use of more conservative investment strategies on a general basis, with firms having a strong tendency to employ less capital-intensive foreign entry methods that were more liquid to pull out or adjust their foreign presence as conditions changed.

4.6 Temporal Analysis

Time-series analysis makes it evident that SME reactions to geopolitical shocks follow certain patterns. They first entail delaying expansion proposals (within 3-6 months of shock occurrences), to be followed by phase-wise adjustment efforts in 12-24 months.

The Brexit referendum exhibited this pattern clearly enough, 28% immediate drop in new EU market access then bounce back after firms had adjusted to new realities. But total EU activity remained 23% below pre-referendum level as of 2021.

5. Discussion

5.1 Theoretical Implications

Evidence confirms and enhances earlier uncertainty theory of SME internationalisation. The significant effect of geopolitical tensions on SMEs is in line with resource-based theory predictions of the limited ability of small firms to respond to external shock. Yet, varying responses by sector and type of firm indicate that conventional "liability of smallness" paradigms need to be extended to encompass differences in adaptation ability.

It also contributes to geopolitical risk research as it shows that the spillover effects extend from direct political ties to envelop more uncertainty spillovers. SMEs curtailed operations in indirectly impacted markets targeted by tensions, indicating risk contagion effects that are worth investigating.

5.2 Practical Implications

Implications for conclusions are paramount to SME managers and policymakers. For CEOs of SMEs, conclusions highlight having agile risk management skills and ensuring strategic agility. Successful firms exhibited capacity to quickly assess an act on shifting geopolitical environments through diversification and cooperative strategies.

The sectoral inequalities implied indicate that focused support programs for sectors will operate more effectively than omnibus programs. Supply chain resilience assistance is needed by manufacturing SMEs, while regulatory management and alternative market access assistance is needed by service firms.

5.3 Policy Recommendations

Research evidence identifies some targeted policy measures, which would be of great utility in managing the SME international business activity challenges in the face of geopolitical uncertainty. These findings are directly derived from the evidence gleaned as much from quantitative analysis as from qualitative judgments of leaders in firms operating within these intricate contexts.

Improved trade promotion is one area of considerable concern wherein government initiative can assist meaningfully in SME market diversification initiatives. Governmental trade promotion agencies are best suited to provide special services that will meet the unique needs of smaller firms that want to de-geopoliticise themselves from unstable markets. This assistance should include in-depth market intelligence services to enable SMEs to get in-depth information they require for assessment of substitute exporting markets, and advanced match-making services to link UK companies with prospective partners and customers in these emerging markets. This would even the balance between competition for SMEs and big companies that generally possess more means for autonomous market data and relationship creation.

Risk management assistance is another key policy domain where public-private partnerships can bring dramatic value-added to the SME sector. The creation and provision of customized risk assessment training courses and analysis tools that can counteract SME resource limitations and decision-making techniques would fill an ideal gap found in the study. These schemes should recognize the acknowledgement that small businesses usually are not able to afford the elaborate risk management framework of bigger counterparts, offering instead functional, lower-cost alternatives that allow effective risk measurement and mitigation within the financial constraints of SMEs.

Financial instrument sophistication is a third priority policy intervention space, in which longer-term export credit guarantee facilities and political risk insurance products would give SMEs the security and cover they need to continue international activity despite geopolitical risk. These kinds of financial products need to be cleverly designed specifically for the exclusive use of smaller firms and to deliver low-cost access to risk mitigation devices for sustained international engagement even when there is increased political tension and uncertainty.

Regulatory streamlining is the last major policy suggestion, which is streamlining market-entry and compliance processes. With less administrative weight in accommodating shifting political climates, governments can better assist SMEs in sustaining foreign operations while keeping scanty resources devoted to the basics of business instead of managing sophisticated regulation. This would be especially advantageous to firms that are engaged in market diversification strategies because streamlined processes would minimize entry barriers in alternative markets and allow for more prompt realignment to shifts in the geopolitics.

5.4 Limitations

This study has several limitations requiring acknowledgment. The survey sample, while representative across key dimensions, may exhibit selection bias toward more internationally active SMEs. Cross-sectional data limits causal inference, despite efforts to address endogeneity through instrumental variables and natural experiment approaches.

Geographic range is limited to UK SMEs, with potential effects on generalizability to other contexts. Future research will need to assess whether patterns established among UK firms are transportable to SMEs in different institutional contexts and with different exposure to specific geopolitical tensions.

The study period (2016-2021) covers a few overlapping shocks (Brexit, US-China tensions, COVID-19) and therefore separating single effects is complicated. While this reflects the real world, it complicates the assignment of observed changes accurately to specific geopolitical events.

6. Conclusion

This article presents strong evidence that geopolitical tensions strongly limit UK SME international conduct, whose impacts are heterogeneous across industries, firm types, and tension types. The 23% overall decrease in new market entry under increased uncertainty is a notable slowing of SME expansion and competitiveness.

Brexit is especially disruptive for UK SMEs, with significant historical reliance on EU markets and low power to adapt. But the research does identify high levels of resilience and adaptability among SMEs, and there are indications that successful companies possess ability to alter direction and see new opportunity in times of uncertainty.

The heterogeneity of impacts implies that blanket policy interventions will fail. Rather, sector-specific interventions to deal with specific sectoral issues and firm capabilities are more likely to enhance SME resilience and internationalization.

Key conclusions are that although geopolitical tensions pose significant challenges to the global operations of UK SMEs, effective proactive risk management and strategic flexibility can counteract most of the negative impacts. A shared feature of companies capable of successfully handling uncertain geopolitical conditions is that they have diversified market portfolios, agile supply chains, good risk appraisal capabilities, and destination market strategic alliances.

The research contribution goes beyond direct policy relevance to shape wider deliberations on the future of globalization. As geopolitical disintegration grows, the understanding of how smaller businesses cope becomes more essential for preserving global economic integration. SME reaction to today's tensions could be an indicator of wider structural shifts in global patterns of trade and investment.

Follow-up studies should take account of long-run adaptation outcomes and confirm whether trends persist across various national contexts. Longitudinal firm-level studies over several cycles of geopolitics would inform us on learning effects and capability building. Comparative studies that look at SME reactions across nations could also investigate best practices and institutions supporting resilience.

UK economics policy implications are clear: facilitating SME internationalization means joined-up responses to short-term shocks and sustained capability development. While tensions between geopolitics are set to continue, building SME resilience is a vital aspect of keeping the UK in an ever more complicated world economy.

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