

CHAPTER 7

INTEGRATING SMALL AND MEDIUM-SIZED ENTERPRISES INTO THE REGIONAL AND GLOBAL MARKETS⁸⁰

A. SMALL AND MEDIUM-SIZED ENTERPRISES: CONTRIBUTIONS AND CHALLENGES

In Asia and the Pacific, small and medium-sized enterprises (SMEs) remain a critical source of employment creation (in many economies of Asia and the Pacific contributing 60% or more of jobs) and income generation (Asian Association of Management Organizations, 2007). While SMEs enhance dynamism in economies by providing flexibility and fresh ideas, they can also stabilize societies by providing safety nets for disadvantaged workers. In this regard, the SME sector has occupied a prominent position in the development agenda of all developing economies in the region; thus, promotion of SME development has been regarded as an important policy issue in those economies.

Another important contribution of SMEs has been in the export sector (table 17), in terms of volume and diversification as well as in technology and skills development. Export operations also expand the base of domestic enterprises, and allow them to develop capacity to compete globally. Thus, SMEs contribute to national competitiveness as apart from income generation. The share of SMEs' contribution to exports varies widely among economies in the Asia-Pacific region, lying between 14.2% for Malaysia and 69.2% for China. This varying ability of SMEs to export may be seen as an indication of (a) how such businesses can or cannot compete in regional and global markets, and (b) where specific support measures may be needed to improve their

performance.⁸¹ In addition, the SME contribution to exports is generally higher in developed economies than in developing economies of Asia and the Pacific.⁸²

With growing governmental concern over SME development, more reforms in SME policies have been witnessed in Asia and the Pacific. SMEs involved with export-oriented products and services as well as those operating the supporting industry for exports have been promoted, and have been recognized for their importance in the export- and FDI-led development strategy that almost all Asia-Pacific countries have adopted. However, SMEs in the region currently face significant resource constraints and have limited capabilities to compete

⁸⁰ Inputs by Paradai Adisayathepkul to this chapter are gratefully acknowledged.

⁸¹ Definitions of what constitutes an SME vary quite widely in Asia and the Pacific and even within single economies. An extreme example is that of China, which defines medium-sized enterprises as those with less than 2,000 employees, while medium-sized enterprises in Malaysia are those with 75 or less employees. Developing economies in Asia and the Pacific typically define SMEs, including micro enterprises, as commercial entities with less than 100 up to 300 employees (ESCAP, 2011b).

⁸² For developed economies, exports are not particularly large components of GDP, while developing economies in Asia and the Pacific are reliant on exports as a significant source of GDP growth (e.g. Malaysia and Thailand) due to their export-oriented development strategies. Generally speaking, a trend can be seen, in that as nations rise to high-income status, their reliance on exports as a driving force of GDP growth is diminished – most likely the result of strong domestic demand growth. In addition, SMEs appear to be the driving source of exports in developed economies, compared with developing economies, at least in the Asia-Pacific region.

Table 17. Contribution by small and medium-sized enterprises in selected economies, various years during 2001-2009

(Percentage)

Countries/areas	Exports in GDP (1)	SMEs in exports (2)	SME share of total enterprises (3)	SME share of total workforce (4)
Developed countries				
France	23.0	42.4	99.8	61.4
Germany	41.0	55.9	99.7	79.0
Japan	13.0	53.8 ^a	99.7	70.2
Spain	23.0	68.5 ^a	99.9	78.7
United Kingdom	28.0	45.9 ^a	99.6	54.0
United States of America	11.0	22.2	99.9	55.8
European Union	n.a.	43.4	99.8	67.4
Asia and the Pacific				
China	27.0	69.2	99.0	74.5
India	20.0	40.0	n.a.	n.a.
Indonesia	24.0	20.0	99.9	99.6
Malaysia	96.0	14.2	99.2	65.1
Pakistan	13.0	30.0	97.9	78.5
Republic of Korea	50.0	39.0	99.9	87.7
Russian Federation	28.0	54.0 ^b	97.6	60.9
Singapore	221.0	16.0	91.5	51.8
Taiwan Province of China	n.a.	17.0	97.8	77.2
Thailand	57.5	30.6	99.6	69.0
Viet Nam	68.0	20.0	99.9	77.3
Federated States of Micronesia	n.a.	n.a.	>90.0	20.0

Sources: World Bank, 2011. Columns (2)-(4): Asian Development Bank (2001); Bank Negara Malaysia (2005); European Commission (2009); Eurostat; General Statistics Office of Viet Nam, Viet Nam; Statistics Korea, Republic of Korea; National SME Development Council, Malaysia (2010); OECD (2005 and 2011); Office of Small and Medium Enterprises Promotion, Thailand; Small and Medium Enterprise Administration, Taiwan Province of China (2010); Tambunan (2009a and 2009b); United States Agency for International Development (2004); and United States International Trade Commission (2010).

^a Value-added.

^b Share of total sales revenue.

effectively in global and regional markets. Despite their tremendous potential, SMEs are still in a disadvantaged position with regard to essential business factors, such as capital, profitability, managerial skills, trained labour, brands and networking. Unless the complex issues and processes of SME development are well understood, isolated efforts to energize the SME

sector may not achieve a significant degree of success.

Within this context, a number of bilateral and multilateral development agencies have designed and implemented SME development interventions in Asia and the Pacific, particularly in less developed economies (ESCAP, 2009a). The

strategic approaches by major bilateral and multilateral development and donor agencies were reviewed in terms of their focused areas and modalities.⁸³ It was found that their specific and detailed interventions to improve value additions in the SME sector, and strengthen their contributions to their respective economics, broadly covered the following seven key areas:

- (a) Enabling policy and regulatory environment, including effective institutional framework and pro-business fiscal policy;
- (b) Supporting infrastructures for business;
- (c) Entrepreneurship, including management skills and human resources;
- (d) Access to finance;
- (e) Technology capability-building and adaptation;
- (f) Business development services;
- (g) Corporate social responsibility.

Based on the analysis as presented above, several key points can be taken for future policy interventions in the field of SME development, particularly in Asia and the Pacific. Firstly, there appears to be a commonly agreed approach for SME development, covering the seven key areas. However, such a comprehensive approach has not been fully adhered to among the various development agencies and donors. This has resulted in scattered activities in various areas/sectors, and the resulting lack of coordination among donors' activities has produced limited results. Secondly, entrepreneurship and its culture have been recognized as one of the key factors for SMEs' growth and competitiveness enhancement; however, traditional technical assistance has not focused on the issue. A comprehensive "entre-

⁸³ The corporate strategies of 13 bilateral and multilateral development and donor agencies on SME development in Asia and the Pacific were reviewed (ESCAP, 2011a). Those agencies include the Asian Development Bank, 2000; Asian Productivity Organization, 2007; United Kingdom, Department for International Development, 2008; German Technical Cooperation (GTZ); International Labour Organization, 2009; Japan International Cooperation Agency, 2006; OECD, 2005; Swiss Agency for Development and Cooperation, 2010; UNDP, 2007; UNIDO, 2010; United States Agency for International Development, 2010 and World Bank, 2002.

preneurship training programme" should be launched, particularly in rural areas. Special preferences could be given to women and youth entrepreneurs to further their development. Thirdly, conventional policy interventions to SMEs have neglected technology development and adaptation, and thus are weak in technical issues and practical solutions. Finally, the importance of SMEs' penetration into regional and global markets has been attracting more attention. The past activities of SME development were typically focused on domestic issues, missing the linkage with existing trade and FDI-driven development strategy.

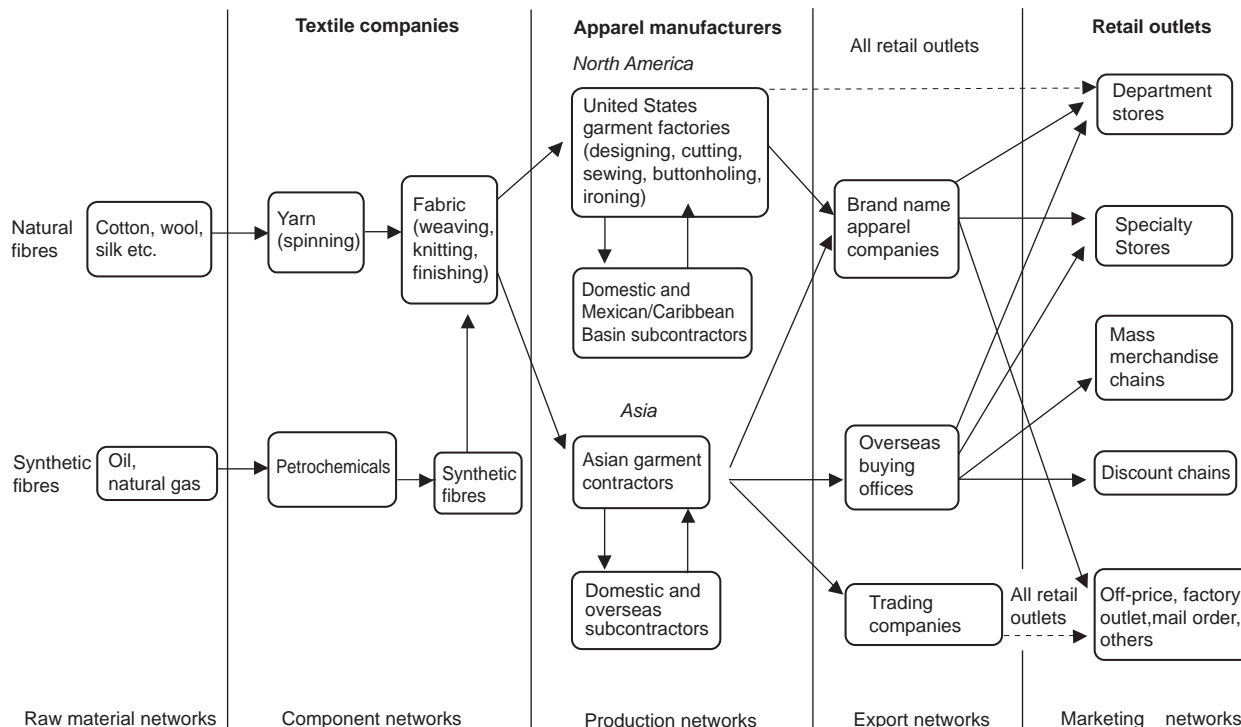
B. EMERGENCE OF REGIONAL AND GLOBAL VALUE CHAINS AND OPPORTUNITIES FOR SMALL AND MEDIUM-SIZED ENTERPRISES

1. Overview

One of the most crucial challenges facing SMEs in Asia and the Pacific is how to create new business (and, therefore, investment) opportunities in global and regional markets, particularly in major emerging economies in Asia and the Pacific such as China and India. In small economies with a limited domestic market, exports play a crucial role in achieving high economic growth and rapid socio-economic transformation. SMEs supplying competitive products and services with greater potential for backward and forward linkages could contribute substantially to exports and, hence, to higher national income and overall socio-economic progress. Therefore, development of export-led SMEs should be an important part of national economic development strategy.

In this regard, recent experiences from a wide range of Asian and Pacific economies, particularly in North-East Asia and South-East Asia, strongly indicate that domestic SMEs can access international markets through global and regional value chains (GVCs). These value chains provide a full range of value-added business activities across borders, and provide a product or service from conception, through design, sourcing raw

Figure 40. An example of regional and global value chains – apparel and garments sector



Source: Gereffi and Memedovic (2003).

materials and intermediate inputs, production, marketing, distribution and support to the final consumers (figure 40). Such GVCs are expected to provide an efficient network by establishing linkages with large enterprises or even with other efficient SMEs. They help to boost SMEs’ value-added activities in international trade, as SMEs currently play a limited role due to low value-addition and lack of proper networking (ESCAP, 2007a).

“Less advanced developing countries can take over some production operations within regional and global value chains through South-South FDI”

Increased intraregional FDI has accelerated the development of GVCs in Asia and the Pacific. Anecdotal evidence reveals that developing economies in Asia and the Pacific are gaining importance as sources of FDI, complementing FDI

from traditional sources in developed economies.⁸⁴ It is noteworthy that compared with the more industrialized and higher income economies, lower income economies have experienced increasing shares of intraregional FDI flows. This indicates that lower income developing economies have received South-South FDI from their more advanced neighbours, which serves as evidence in support of the “flying geese” paradigm – the catching-up process of industrialization in less advanced economies (ESCAP, 2009a).

Less advanced developing economies can take over some production operations within regional and global value chains through South-South FDI. This trend is expected to lead to a gradual industrial transformation from relatively low value-added sectors (e.g. agriculture and garments) to high value-added sectors (e.g. automotive parts and

⁸⁴ For a more detailed analysis, see ESCAP, 2010.

electronics or advance manufacturing, ICT and services). FDI in high value-added sectors can facilitate technology and knowledge transfer and diffusion to less advanced developing economies. In this connection, it may be desirable to explore further investment opportunities for Asia-Pacific SMEs in advanced manufacturing and related value chains.

However, the emergence of GVCs has also resulted in intensified competition in high value-added activities and a need for continuous skills development. Such competition is likely to widen economic and development disparities in the region, at both the national and the company levels, unless national policymakers, in cooperation with business people and international development agencies, create an environment to maximize SMEs' benefits from GVCs. In order to effectively participate in GVCs, SMEs must break high entry barriers by meeting a wide range of increasingly stringent global standards with regard to quality, price, timely delivery and flexibility. As reviewed above, however, SMEs in Asia and the Pacific typically lack the environment to improve their capacity, including a proper policy and regulatory framework, supporting infrastructures, access to finance, strong entrepreneurship culture, technology incubation and business development services (ESCAP, 2009b).

2. Challenges for Asia-Pacific small and medium-sized enterprises in regional and global value chains

The practical challenge for SMEs in developing economies in Asia and the Pacific is to become and remain competitive suppliers, particularly in GVCs. SMEs, which seek to establish partnerships in regional and global value chains, should understand the governance of the specific value chain process and structures. As international trade is mostly undertaken by large enterprises of global reputation, and since leading firms in global/regional value chains are the key decision makers in managing global production systems and trade, they would be the ones influencing the participation of smaller firms in such chains. It is important that the structure of a specific value chain and the

specific characteristics of the lead companies are fully understood.

“In the absence of support services, SMEs in Asia and the Pacific developing economies cannot establish effective value chain connections at either the regional or the global level”

It is a fairly well-established fact that a product's quality and value not only depend on regular innovations in the production process but also on innovations outside the production process (e.g. design and marketing) in order to cater to different customers and markets. Therefore, with the provision of support services, both from public sector agencies and business associations, is a necessity for SMEs. In the absence of such services, SMEs in Asia and the Pacific developing economies cannot establish effective value chain connections at either the regional or the global level. Governments must therefore play a leading role in facilitating SME growth, by providing the necessary support for export-oriented SMEs as well as industrial SMEs to allow them to form strong partnerships in regional and global value chains. Participation in these chains often implies ability of SMEs to break high entry barriers by meeting a wide range of increasingly stringent global standards with regard to quality, price, timely delivery and flexibility. SMEs in Asia and the Pacific typically lack the standards and infrastructure necessary to enable them to demonstrate conformity with such standards. Therefore, additional efforts by Governments as well as reliance on new approaches to breaking these barriers (such as mutual recognition agreements in ASEAN or the use of private certification) are required. These and other challenges can best be understood within the context of specific industry value chains that have particular relevance for regional economies. In this context, three sectoral value chains of actual and potential relevance for Asia and the Pacific were selected in this analysis to illustrate the challenges, i.e. agribusiness, garments and apparel and automobile components (box 7.1).

Box 7.1. Challenges in regional and global value chains: three case studies

A. Agribusiness^a

The agribusiness sector has been one of the most vibrant growth sectors internationally, with many of its products sourced from developing economies in Asia and the Pacific. The evolution of agribusiness GVCs, coupled with the dominance of large retailers/supermarkets that control the brands of agro-products and access to regional and global markets for agro-products imported from developing economies, threatens the exclusion of suppliers unable to meet the new requirements. However, it also provides significant opportunities for those who can do so. For example, the trend towards product differentiation such as organic produce, driven both by the tastes of global consumers and by strategies of retailers for higher revenue, is producing significant opportunities for qualified Asia-Pacific SMEs to serve niche markets that are regional or even global in nature. Furthermore, outsourcing by global retailers of technically sophisticated activities, such as bar-coding, labelling and the preparation of ready-to-eat food, provide important opportunities for upgrading within the agribusiness GVCs in Asia and the Pacific.

B. Garments and apparel^b

The garment and apparel industry, which is one of the oldest and largest export industries, and a classic “starter” industry for export-oriented industrialization, has played a key role in the industrialization and development of Asia and the Pacific. It represents a typical buyer-driven value chain/network, with a highly competitive and widely dispersed global industry structure, including regional and local competitors. Entry barriers are relatively low for most “assembly” garment factories, and they increase with movement up the global and regional value chains from textiles to fibres. Two key factors shape the structure and dynamics of the apparel GVCs: (a) pressure to meet stringent international standards (e.g. labour and environmental); and (b) demands from global buyers for cheaper products, higher quality and shorter lead times.

The increasing concentration of production in economies with the capability for “full package production,” particularly China and India, are also expected to have a significant “demand side” effect. It is expected that large retailers will demand further price cuts as well as reduce the number of their suppliers. This will place significant pressure on those exporting countries without primary textile industries, such as Bangladesh and Cambodia, and on smaller producers whose present capabilities to upgrade within a GVC are limited.

C. Automobile components^c

The automobile components industry comprises a complex mixture of firms of very different sizes, types and geographic scope, producing an enormous variety of products ranging from very simple parts to technologically very complex systems. The potential for local sourcing is particularly high because of the large number, size and weight of components and materials required by the sector. For those SMEs able to participate even at the lowest tiers of production, the automobile components industry can offer significant opportunities for those SMEs in the region that are able to participate, even at the lowest tiers of production, to access regional and global markets.

In Asia and the Pacific, cost competitiveness of the automotive component industry is often based less on productivity and more on low factor input costs, which are now rising in many countries (e.g. the cost of labour and land). Therefore, the key challenge for automotive parts suppliers in the region is to improve productivity and lower their costs in order to maintain or improve their competitive performance within a GVC. In this context, a coordinated strategy of production relocation and integration within the region could provide opportunities for neighbouring less developed, lower-cost economies to become lower-tier suppliers of selected components for the existing automotive parts cluster. Such cross-border production linkages could provide an entry point to the automotive parts GVC and exposure to its significant developmental benefits while at the same time strengthening the competitive performance of local SME suppliers.

^a Particularly useful sources for this case study include Humphrey (2005); and Dolan, Humphrey and Harris-Pascal, 2000study.

^b Particularly useful sources for this case include Gerefi and Memedovic (2003), International Trade Centre UNCTAD/WTO (2005), and Nadvi and Thoburn (2003).

^c Particularly useful sources for this case study include Global Production Networks (2003), Veloso and Kumar (2002), and Sturgeon and Lester (2001).

3. Implications and opportunities for small and medium-sized enterprise development

The above analysis reveals the following key policy implications as well as opportunities for SME development in Asia and the Pacific.

(a) *Opportunities for new entrants*

It is now possible for SMEs to become internationally competitive in an increasingly wide range of industries, based on a single function or a small number of functions, as suppliers in GVCs. Similarly, through participation in GVCs it is possible to achieve large-scale exports of specialized outputs in niche product markets that are regional or even global in scale. Ultimately, SMEs can emerge as overseas investors in their own right and, as they grow, develop their own value chains through forging backward and forward linkages.

(b) *Opportunities for value creation*

In a world of GVCs, key differences in the competitive performance of SMEs lie less in the industries of which they are a part than in the functions or activities in which they choose to specialize. It is not the industry or sector that is most important but a firm's core capabilities within a particular industry value chain. Opportunities for value-creation exist anywhere along the industry value chain through specialization and upgrading.

(c) *“Match the best”*

International business is increasingly being characterized by fragmented and specialized production within the framework of GVCs, driven by strategic decisions on the reorganization and relocation of production. To be competitive, SMEs have to be the “best in their class” for each activity, function or output they choose (e.g. manufacturing activities, design, logistics and marketing). Unless they are able to “match the best” they are unlikely to be able to compete effectively in regional and global markets, given the range of globally available supplier options in most industries.

(d) *Cooperate to compete*

Cooperation through SME clusters plays a key role in SMEs in the region achieving competitive success. Such SME clusters are anchored in partnerships along three dimensions: (a) SME-to-SME, through joint task-related activities and initiatives that also support building trust and shared experiences; (b) between core producer enterprises in such clusters and supporting institutions that provide key services such as training, logistics and business development services; and (c) business-government cooperation to strengthen GVC-related business institutions.

(e) *New challenges for development strategy*

Local SMEs must increasingly have the required capabilities to even be considered by first-tier global suppliers or lead firms in GVCs. In this context, a key role of government is to assist in developing the required supplier capabilities, including assistance in strengthening industry-related institutions as well as to ensure the availability of competitive support systems such as logistics services. This is an essential element in supporting the competitive performance of domestic firms in international markets and increasingly in attracting investment.

(f) *New directions in regional trade facilitation*

Within the framework of global value chains, it is essential to ease exports and imports of parts and components as well as of final products. This requires effective trade-facilitation processes (such as customs procedures, and import and export regulations) as well as competitive support services such as the transport and communications infrastructure within the framework of integrated trans-border logistics systems. The related challenge to regional cooperation is to move towards a more integrated approach to transport, trade and transit within the framework of market-oriented and relatively open trade policy regimes, which is focused on specific industry value chains of shared interest.

“The transformation of regional businesses by the emergence of global value chains signals potentially new and important directions for SME development in Asia and the Pacific”

C. FOUR ADVANTAGES OF THE VALUE CHAIN APPROACH FOR SMALL AND MEDIUM-SIZED ENTERPRISES

SMEs in Asia and the Pacific form the largest generator of domestic employment and provide a livelihood for more than 60% of the region’s workforce, especially women and young people. The most serious challenge facing SMEs is how to create new business opportunities for more value-added products and services, especially tradable ones, which are very much in line with the region’s commonly-accepted trade and FDI-led development strategy. Obtaining access to profitable export markets is crucial to fostering SME growth and productivity, especially given the increasing globalization and market liberalization.

The transformation of regional businesses by the emergence of global value chains signals potentially new and important directions for SME development

in Asia and the Pacific. The GVC approach, in particular, provides the following four advantages for SME development at the national and regional levels:

- (a) In recognition of the diversity of developing economies of the region in terms of economic status and condition, and natural endowment, the specific sector value chain-based approach could identify development issues more easily, while the “one size fits all” tailored approach may not be workable in all participating countries;
- (b) The approach covers the seven essential issues for SME development, as mentioned above, through comprehensive development programmes;
- (c) The value chain approach will force policy-makers to adopt a programme for regional cooperation that moves the development assistance paradigm beyond national borders;
- (d) The value chain approach is closely linked to the attraction of appropriate FDI, which plays an important role in the development of value chains and, therefore, helps in promoting intraregional FDI.