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## Improving Institutional Support to Small and Medium Enterprises

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The experience of Northeast Asia indicates that a strong and viable small and medium enterprise sector is important for a successful export-oriented industrialization. Small and medium enterprises (SMEs) increase the flexibility of supply to cater to rapid changes in overseas demand. They enjoy the advantages of small scale economies, especially considering that at the country's current stage of industrialization, the focus is on labor-intensive manufactures. SMEs support the export sector primarily through the subcontracting mode and as supplier of specialized inputs and, possibly, parts and components. They are also known to be the seedbed for entrepreneurial talent and a testing place for new industries (Chen 1986, pp.3-4).

Recent analyses bring out even more the importance of SMEs in export-oriented industrialization and the drive for increased international competitiveness. Specifically, there is a growing view that in the current context of a fast changing international economy, an industry's vitality depends upon "low levels of market friction" (e.g., minimum transactions costs of doing business) and a "high degree of flexibility" (Meyanathan and Munter, 1995, p.2). Flexibility is important in the light of the increasingly shorter product cycles, greater product diversity and growing demands for product and service differentiation. It is likely that a broad based industrial structure with strong interfirm linkages among and between the large enterprises and the SMEs (through subcontracting, among others) would result in a high degree of flexibility.

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The author is President of the Institute. The views expressed are those of the author and do not necessarily reflect those of PIDS or any of the study's sponsors.

## SMEs as economy's backbone

The SME sector has been the backbone of the economy and served as an important ingredient in the economic and export success of such economies as Japan, Hong Kong and Taiwan. In Hong Kong in 1981, for example, enterprises employing less than 50 workers represented 91.6 percent of all establishments, 40.5 percent of all workers and 29.8 percent of the total gross output of the manufacturing sector. These enterprises contributed 32.7 percent of manufacturing value added and 7.1 percent of the overall gross domestic product (Chen 1986, pp.4-5). In Taiwan, SMEs accounted for 98 percent of all enterprises, 62 percent of all manufacturing enterprises, 70 percent of the employed population, 55 percent of the gross national product and 48 percent of output value during the late 1980s (Meyanthen and Munter 1995, p.11). Although the importance of SMEs is less in South Korea compared to Taiwan, they still accounted for 40 percent of manufacturing value added and 60 percent of manufacturing employment in South Korea (Ibid. p.10). In Japan, SMEs accounted for 99.4 percent of all manufacturing enterprises, 66.7 percent of all manufacturing employment, and 51.7 percent of manufacturing output in 1993 (MITI 1995, pp.211-12).

In the Philippines, SMEs accounted for 97 percent of the total number of manufacturing establishments and 50 percent of manufacturing employment in 1988 (Sharif 1995, p.47). However, firms with employment of less than 200 accounted for only 23 percent of the manufacturing census value added in the Philippines in 1988 (Tecson 1996, Appendix Table 1).

## Focus on SME development

SME development can arise from general policy reforms and from targeted "industrial extension" activities of the government. Results of the study of Medalla, Tecson, Bautista and others (1995) show that the country's trade liberalization program during the latter 1980s encouraged the growth of SMEs. Specifically, as a result of the trade liberalization program and the recovery of the economy, the number of manufacturing plants doubled during the period of 1983-1988 at the same time that the average number of workers declined by nearly 40 percent. In other words, more SMEs sprang. Perhaps, more importantly, the percentage of firms in the manufacturing sector that became socially efficient by 1988 rose largely because of the greater proportion of SMEs that were socially efficient. The growth of the SMEs arising from trade liberalization is probably not surprising because trade liberalization al-

lows SMEs greater access to more cost competitive inputs compared to the period when imports were controlled. Moreover, the increased exports of manufactures encouraged the use of subcontracting.

Apart from general policy reform measures, SME development can be pursued through more targeted interventions akin to an "industrial extension" system. In this regard, it is useful to bring out the approaches of the Tokyo Metropolitan Region and Singapore in developing SMEs.

The Tokyo Metropolitan Small and Medium Enterprises Promotion activities include the following:

- ❖ ***promotion of subcontracting*** through match-ups of companies placing and receiving orders (through registration with the agency), provision of subcontracting advice, technofairs for subcontracting enterprises, assistance in the cultivation of new business partners, guidance in improving subcontracting transactions, counselling and guidance services where there are problems in subcontracting, and others;

- ❖ ***establishment of a small and medium enterprises promotion fund*** that is used in providing limited subsidies for project planning and development and market surveys of SMEs, tech-

nology development, design development and human resource training to develop new products of traditional technical arts, promotion of joint research and technology development projects of the SMEs, the universities and the government, and others; and

❖ **equipment leasing and installment plans for SMEs at market based long term interest rates.**

The SME program of the Tokyo Metropolitan Region is undertaken by a foundation with initial funding and endowment from the government. Each prefecture in Japan has an SME development program similar to the Tokyo Metropolitan Region.

Singapore, meanwhile, has a comprehensive set of programs for the development of SMEs. Among the salient programs are the following (Wong 1995):

❖ **Product Development Assistance Scheme**, which provides grants of up to 50 percent of the direct development cost of a project;

❖ **Investment Allowance Scheme**, which allows tax deductions from 10 percent to 50 percent of approved new fixed investments of SMEs of at least 30 percent local ownership;

❖ **Small Industries Finance Scheme**, which together

with the Development Bank of Singapore, provides loans for fixed assets for further development and technical upgrading;

❖ **Small Industries Technical Assistance Scheme**, which provides grants to enable SMEs to seek external expertise to upgrade their operations;

❖ **Business Development Scheme**, which provides grants to SMEs to explore overseas marketing and technology tie-up opportunities; and

❖ **Skills Development Fund**, which provides financial assistance to SMEs for their training needs and for upgrading and modernizing their operations

Singapore has a **one stop consultancy agency for SMEs** which has a general assistance department, a loans and grants department and a planning and coordination department. It also has an institute (Singapore Institute of Standards and Industrial Research) that helps the SMEs by providing testing facilities and extending assistance on quality management, standardization, improvement in the design of products and processes, and development of new products.

A particularly innovative program is the **Local Industries Upgrading Program** which involves the adoption by multinational enterprises of their SME

subcontractors and suppliers. Grants of up to 90 percent of the training costs are provided to the multinational enterprises for training the SMEs in areas such as quality control, production process, technology, management and equipment. The other 10 percent of the training costs is borne by the SMEs (Wong 1995).

Singapore's Local Industries Upgrading Program, which is primarily in the electronics and engineering industries, is one example of the programs implemented by various countries in the region which seek to strengthen the linkages between the large enterprises and the small and medium enterprises primarily by improving the absorptive capacities of the SMEs. A similar scheme is Taiwan's **Center-Satellite Factory System** which is a "...coordination institution that aims to upgrade product quality, improve product specialization, and accelerate industrial development through improved cooperation between complementary enterprises. Taiwan has a well established and extensive network of public and private institutions cooperating together to provide focused assistance on management, financial and technical support to SMEs" (Meyanathan and Munter 1995, p.12). Other similar schemes are the "**umbrella strategy**" of Malaysia whereby one large "umbrella" company with the necessary financial resources and expertise helps to coordinate production and marketing for

SMEs and provides skill and management training, and the “**foster father**” plan of Indonesia (ibid). In the case of Malaysia, tax incentives are provided to promote subcontracting between multinational enterprises and local SMEs. Finally, both Singapore and Indonesia have instituted industrial clusters by relocating related SMEs in part to enhance the technical assistance given them.

### Recommendations

Considering the importance of SMEs in the economic and export drive of the country, it is important that the government strengthen its institutional support to the SMEs as well as strengthen its institutional capability for supporting SMEs. This means that well designed programs of interventions, of which the approaches of the Japanese, Singaporeans, Taiwanese and Malaysians are useful references, should be introduced and adopted.

Some of the more important measures that the government may undertake to encourage the growth and modernization of the country’s SME sector are:

❖ **vigorously encourage subcontracting.** In Japan in 1981, 65 percent of SMEs produced their products under subcontracting arrangements. Of this, 82 percent specialized in subcontract production (i.e., 80 percent or more of their output is under

subcontract arrangement). The subcontracting system was most extensive in the machinery and textile sectors (Nagaoka 1989, pp.35-36). The institutional support measures utilized by the Tokyo Metropolitan Region to encourage subcontracting are worth implementing in the country. These include firm registration and match-ups, advisory and guidance services, and mediation and conflict resolution services.

❖ **encourage SME-LE linkages.** The Singaporean and Taiwanese cases are potential models. In Singapore, a large percentage of the cost borne by the large enterprises for the training of SMEs is reimbursed by the government. This program can be expanded to include increased linkages between the local SMEs and foreign SMEs operating in the country.

❖ **equipment leasing and installment plans for SME modernization** This is similar to the Tokyo Metropolitan Region program. The program need not be administered by a government agency. It can be undertaken by private leasing and installment firms but with lending support from the government.

❖ **expansion and strengthening of SME promotion activities.** Again, the Singaporean and Tokyo Metropolitan Region programs are notewor-

thy and may serve as models for the country. DTI’s Tulong sa Tao program and the Industrial Loan Guarantee Fund are examples of support being provided to the SMEs. It is apparent however that the programs in the Philippines are not as wide ranging as in Singapore and Japan. In view of the much larger number of SMEs in the Philippines than in Singapore and given the limited budget for SME promotion activities, it is clear that there is a need for some prioritization. It is best that the funds are targeted for SME modernization, export competitiveness and increased technological capability.

❖ **establishment of common service facilities.** This is meant to reduce the capital cost to SMEs and may have to be undertaken on an industry basis. For example, the ceramics industry has proposed the establishment of common service facilities for flatware production, model mold making, color mixing and raw materials processing (Export Development Council). The common service facilities can be undertaken for a fee by the private sector but with long term financing and possibly slight implicit subsidy to the beneficiaries.

Strengthened support for the SME sector also means **increased reliance on the private sector or joint public and private sector in the provision of the institutional support** in order to de-bureaucratize as much as pos-

sible the provision of support services and to allow the utilization of better paid and more efficient personnel. It also calls for **improved institutional capacity in the government to undertake what is essentially an “industrial extension system,”** akin to the “agricultural extension system” but with greater reliance on market forces and the private sector. This implies stronger coordination of government agencies and increased funding for the “industrial extension system.” 

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