

EXECUTIVE SUMMARY:

ASIAN SMES AND GLOBALIZATION

1. AIM OF THE STUDIES

Large enterprises (LEs) and small and medium enterprises (SMEs) are the two important wheels of development in developing countries. While multinational enterprises (MNEs) and domestic LEs have been playing an important role in accelerating the industrialization process, SMEs provide the crucial industrial linkages to set off a chain reaction of broad-based industrial development. Without SMEs as subcontractors and suppliers of intermediate inputs to MNEs and domestic LEs, industrial growth in developing countries will not be able to realize sustainable increases in the domestic value added, employment, productivity, and industrial linkages.

In the globalizing era of a borderless world, buttressed by regionalization and liberalization, SMEs provide an important source of domestic employment creation, resilience against external economic fluctuations, and mechanism for local capacity-building. Indeed, SMEs are important in economic development of all countries.

This project aims to examine SME policies in Asian countries within the framework of globalization and to submit policy recommendations, taking into account the different stages of industrialization and business environment development in different participating countries.

2. STUDY METHODOLOGY

This project focuses on SMEs' manufacturing sector only. Although traditional cottage industries in rural areas are important in developing countries, such related analysis should come from the viewpoint of social policies and rural development.

Since this project tries to find effective ways to promote industrialization, traditional cottage industries are excluded.

This study covers the following countries: Cambodia, China, India, Indonesia, Japan, Laos, the Philippines, Singapore, Thailand, and Viet Nam. Each country-specific study has two components: secondary data analysis and field studies.

2.1 Analysis of the Secondary Data

SMEs in the 10 countries mentioned above were assessed from four viewpoints: innovativeness, market expansion, competitiveness, and networking. Innovativeness includes not only product and process innovation but also as an approach to access new business opportunity. Market expansion covers both domestic and export markets. Competitiveness is considered as a relative position of an SME in the production process by taking into account quality, price, and delivery time. Networking includes subcontracting between LEs and SMEs, collaboration among SMEs, and linkages with governments and other support agencies. The activation of agglomeration effects by promoting coordination among SMEs is becoming a major strategy of SME policies in developed countries.

2.2 Field Survey

Field surveys were conducted in order to strengthen and verify conclusions from the secondary data. Since data on SMEs are neither adequate nor comprehensive in many ASEAN countries, field surveys were necessary. Due to time constraints, the field surveys focused on only one of the above listed viewpoints—SME networking. The targets of the surveys were enterprises employing fewer than 100 workers.

3. FINDING AND CONCLUSIONS

3.1 Direction of SME Policies

In many cases, SME policies have tried to achieve contradicting objectives like protecting and promoting SMEs at the same time. Whereas a social safety net is necessary to protect jobs and production in SMEs, it must not mean providing long term

protection against competition. The private sector should take initiatives in the process of SME development. Intervention by government over time would create economic distortion and mis-allocation of scarce resources. The role of SME policies is to facilitate the smooth functioning of SME development. SME policies should be flexible enough for SMEs to be able to easily adjust to them.

3.2 Dynamic Change of Asian Economies

3.2.1 Subcontracting

Automobile and electrical industries consist of MNEs and foreign or joint venture subcontractors in the first tier in many Asian countries. As production volume increased in the Thai automobile industry, MNEs and foreign or joint venture subcontractors in the first tier began to procure components and parts from local companies. Local SMEs in the second and third tiers are formed to supply parts to the subcontractors in the first tier. At this stage technology is transferred from MNEs to local companies efficiently and agglomeration effects become useful.

3.2.2 Business Environment

MNEs are being strict at selecting subcontractors in ASEAN countries. Only a small number of local SMEs have the chance to be selected as subcontractors in the second tier. Hence, SME promotion policies, simultaneously, should improve competitiveness of existing non-subcontracting enterprises. Moreover, policies should consider the initiatives of the private sector and improve business environments rather than being directed to meet the specific targets defined by the government.

Labour intensive industries in Thailand are losing their competitiveness because of high wages. Analysis suggests that labour intensive industries may shift from Malaysia and Thailand, where wages are rising, to other countries in the future. Low wage is a consideration for international competitiveness in labour intensive industries like apparel. Improvements in the business environment, for example establishing a legal framework, bringing about stability of the macro economy and creating infrastructure is crucial for the development of SMEs in Cambodia and Laos. The importance of these factors is emphasized with increasing competition in international textiles and garment markets following the abolition of the Multi-fiber Agreement

(MFA) in January 2005. Similarly, for some countries like India and the Philippines, extending benefits to workers engaged in apparel global production networks (GPNs) requires policy attention.

3.2.3 Networking

Both China and India have experienced dynamic and rapid economic growth. Since domestic markets are expanding, subcontracting systems involving local LEs and SMEs have developed. Coordination and exchange of information among SMEs are very important to activate agglomeration effects of industrial clusters. Moreover, SMEs can play an important role to absorb increasing labour force and thereby reduce the problems of unemployment.

3.3 Country-wise Analysis

3.3.1 Cambodia

Majority of the Cambodian SMEs are still in a very early stage of development. In 2005, over 80 percent of Cambodian industrial SMEs were engaged in food, beverage, and tobacco industries. The SME sector is dominated by family businesses with fewer than 10 employees, processing primary produce for the domestic market. Cambodian SMEs typically use very basic technology and have low total factor and labour productivity. As globalization deepens they are struggling to compete with imported goods manufactured by SMEs in neighbouring countries. There are three key factors impeding the development of Cambodian SMEs: the country's weak regulatory and legal framework, SME access to finance, and lack of SME support facilities.

3.3.2 China

SME clusters have been formed in developed coastal areas. Each cluster consisting of one or more towns concentrates on one product. By obtaining economies of scale and scope, SMEs in the clusters can enhance efficiency and reduce costs. Field surveys were undertaken in the Guanlin cable cluster, Shengze textile cluster and Hengshan sewing machine cluster. In these clusters, cooperation among SMEs for procurement and marketing is found common. Division of labour among SMEs is also

observed in these clusters. Nevertheless, financing is a major constraint facing SMEs. Although the SME promotion policy was enacted in 2003, its impact has been limited.

3.3.3 India

Small enterprise promotion has continued to remain an important and integral part of Indian development strategy well before the First Five-Year Plan. Some of the most persisting constraints facing the sector, dominated by smaller units in the informal sector, include poor or non-availability of loan finance, low levels of technology, inadequate physical and economic infrastructure, and a policy of product reservation for small scale industries, which excludes entry of LEs. Poor monitoring of implementation and effect of various small firm policies has been an issue of concern. There has been a definite decline in the access to credit by small enterprises among SMEs. Given the large scale attempts to promote industrial clusters in the SME sector, cluster promotion in the Indian context must move beyond the 'sectoral' bind.

3.3.4 Indonesia

Whereas the local content policy succeeds in creating strong interdependence between SMEs and LEs due to the government's excessive interference, private sector-led subcontracting networks increase in some industries. There are two tiers of subcontracting in metalworking industry in Tegal—first, between large and medium enterprises, and second, between medium and small enterprises. Ample empirical evidence exists to establish that SMEs are able to undertake innovations. In the Tegal metalworking industry a group of entrepreneurs had successfully produced a hand tractor with its own design fit for the domestic market. However, productivity in SMEs is lower than that in LEs.

3.3.5 Japan

Japanese SMEs have stood on the crossroads since 1991. Many LEs shifted labour intensive processes from Japan to Asian countries and began not only to procure components and parts from local markets but also to import them into Japan from Asian countries. Moreover, long-term recession forced the machinery industries to review their procurement strategy. Automobile and electrical equipment manufacturers

changed ways of procurement at three points. They began to procure components from the companies under different groups, reduced component types, and raised the share of components and parts produced in-house. Rationalization of procurement by LEs led to the selection of only efficient subcontractors and ended transactions with inefficient ones. The change of procurement policy by LEs might have caused bipolarization among SMEs.

3.3.6 Laos

Not only the average wage for the Lao worker is lower than that in the neighbouring countries, the labour productivity is lower as well. The Generalized System of Preferences (GSP) granted by the EU has contributed to an increase of exports of handicrafts, silk, and textiles. The major obstacles for SMEs are mainly high tax, high inflation, unstable exchange rate, and lack of investment funds. In the garment industry, FDI provides opportunity to SMEs to increase their output through subcontracting production linkages. While foreign contractors lend sewing machines to garment units and provide advance payments, collaboration among garment SMEs is not common. Trade liberalization seems to have negative impact rather than positive impact on SMEs.

3.3.7 The Philippines

A decline in subcontracting ratios was observed in wearing apparel, machinery except electrical, electrical machinery, and transport industries from 1994 to 2003. This indicates that the local content of the country's leading exports has remained low and declined substantially. The deepening of high technology industries such as the electronics and auto parts and components in terms of the creation of backward linkages within the Philippine manufacturing industry has remained weak. In the Philippines, the most important factors for subcontractors in maintaining good relationship with the contractors are product quality, timely delivery, and low cost. The high levels of protection in the past explain the lack of competitiveness in many of the country's manufacturing industries.

3.3.8 Singapore

SPRING Singapore is the lead government organization to spearhead, plan, and assist SME development in Singapore. It has identified three key factors fundamental to the development of SMEs—human resources, technology, and financing. Financing is particularly critical in the early stage of SME development. The most challenging issues facing Singapore SMEs are increasing operation costs, competition both in domestic and external markets, shortage in qualified manpower, and technology upgrade to enhance access to the external market.

3.3.9 Thailand

In the Thai automobile industry, the transfer of production capabilities is moderately successful, while the more advanced capabilities such as design has been relatively limited. Since the abolition of the local content requirement policy in 2000 and liberalizing trade policy, many Japanese and US automobile assemblers and auto parts manufacturers have turned Thailand into a major export base for their global operations. The field survey revealed that interfirm technology transfer became more intensive than it had been in the past. The more active role of suppliers and their increased ability to take part in the product engineering process have become increasingly important.

3.3.10 Vietnam

SMEs have experienced a phenomenal growth in the number of registered enterprises and investment especially since 2000 when the Enterprise Law was promulgated. Vietnam's SMEs remain weak in terms of both internal and external networking, competitiveness, innovativeness, human resource, and readiness to go global. Apart from the overall development of SMEs from the beginning, these weaknesses have been largely due to the prolonged discrimination against the private sector regarding access to key factors of production, especially, credit and land, lack of a pro-private and competitive business environment, poor quality of human resource and poor availability of business development services.

4 POLICY RECOMMENDATIONS

Assistance to SMEs must be based on long-term comprehensive, coordinated and consistent policy. Often, empirical evidence shows that effective policy measures for SMEs in developing countries are not coordinated among relevant ministries, agencies, and organizations which in the long run are not even consistent. Therefore, we must develop "best practices" on business environment, subcontracting and networking, and monitoring mechanism to ensure that SME policies are efficiently and effectively carried out. Successful case studies invariably indicate that an effective collaboration between the government, trade associations, and educational or training institutes is important to reduce costs for human resource development. Likewise, disseminate information through the effective use of available information and communication technology (ICT).

4.1 Networking and Clustering

The development of SMEs often requires effective clustering and networking which are developed and made accessible by conscious effective government assistance programmes such as industrial incubators, industrial parks for SMEs, and industrial apartment (e.g., Kojyo apartment in Japanese). Effective cluster environment may create synergy and adequately compensate serious multifarious shortages of resources often faced by SMEs.

In many countries, central governments are taking the initiative of planning and implementing SME policies. Often, the critical role of local authorities and relevant agencies are absent or negligible. Effective implementation of SME policies must be undertaken and monitored by local governments, agencies, and organizations with adequate funding and support provided by national governments. Local government can play the critical role to create database of SMEs and set up a forum of SME owners and local governments.

4.2 Improving SMEs Database

There is a need to both streamline and improve the quality of database on SMEs and clusters. Through the use of ICT, these data sources can be made accessible to a wider group of users and be rendered policy responsive.

4.3 Enhancing Product and Process Quality

In most Asian countries, towards enhancing SME competitiveness, efforts can be made to introduce easier provisions for ensuring quality certification. Therefore, there is a need to establish local and regional product testing and quality standards institutes as public goods for SMEs.

4.4 Ensuring Competitive Domestic Market Structure

Anti-monopoly regulations should be enacted and implemented to ensure market access for SMEs. In this context, the establishment of SME “incubators” will be helpful to enhance new entry and competitive environment.

4.5 Subcontracting

The establishment of joint technology centers by major FDI countries will be a useful mechanism to disseminate information and training to local SMEs as part of capacity-building. An example is the establishment of Japan-Singapore Software Technology Center. In addition, the governments should encourage trade fairs for procurement to promote subcontracting between MNEs and SMEs. At the trade fairs, MNEs can exhibit components and parts which they are interested to procure.