

9. SME POLICIES IN THE AGE OF GLOBALIZATION

For the purpose of pursuing deepening economic integration and narrowing development gaps in East Asia, the role of small and medium-sized enterprises (SMEs) are of particular importance. On the one hand, SMEs are expected to play key roles in production networks as suppliers of parts and components. On the other hand, SMEs are expected to function as devices to spread the benefits of economic integration extensively to each country. In order to bring out SMEs' potential, SME policies should be directed to utilizing globalizing forces by facilitating the effective participation into the growing production and distribution networks.

An ERIA research project entitled “*Asian SMEs and Globalization*” has been conducted to examine SME policies in Asian countries within the framework of globalization, taking into account the different stages of industrialization, policy and business environment development in different participating countries. This chapter summarizes the findings and policy recommendations thereof¹³.

9.1. The changing role of SMEs in the age of globalization

Large enterprises (LEs) and 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 functioning as subcontractors and suppliers of intermediate inputs to MNEs and domestic LEs, industrial development in developing countries will not be able to sustain 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 a mechanism for local capacity building. It has been widely acknowledged that SMEs are important for economic

¹³ The discussion in this chapter is based on Lim (2008a).

development in all countries.

9.2. Current status and challenges of Asian SMEs

9.2.1. Direction of SME policies

In many cases, SME policies have tried to achieve contradicting objectives, i.e., 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, as intervention by government over time would otherwise create economic distortion and misallocation 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.

9.2.2. Dynamic change of Asian economies

(1) Subcontracting

Automobile and electrical industries consist of MNEs and foreign or joint venture first-tier subcontractors 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.

(2) Business Environment

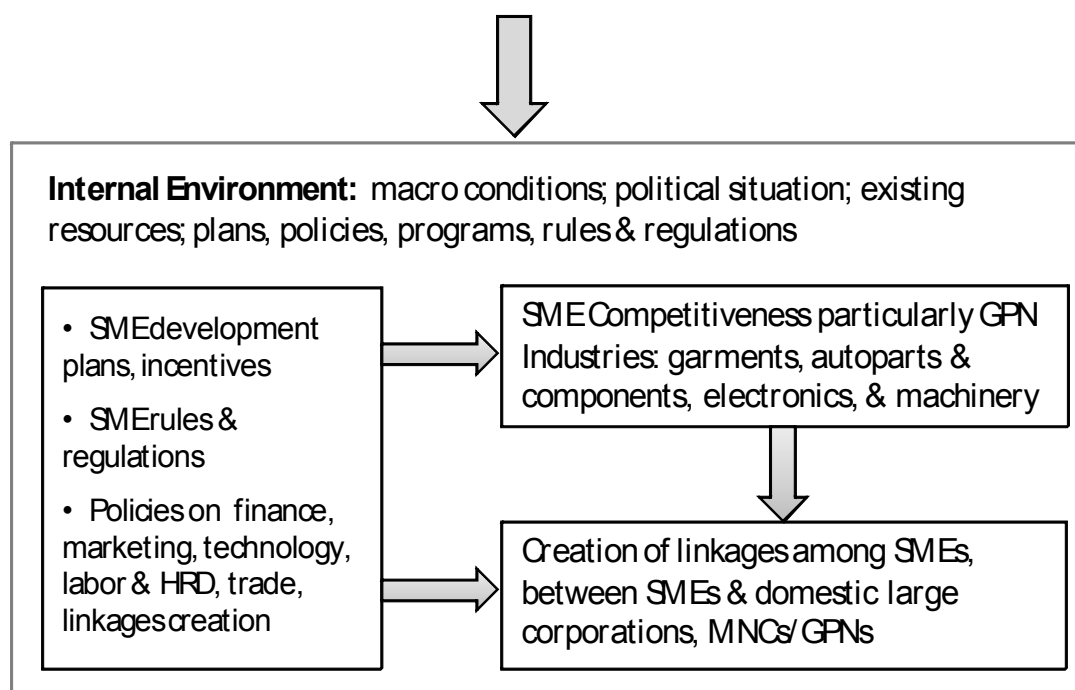
MNEs are strict at selecting subcontractors in ASEAN countries. Only a small number of local SMEs have the chance to be selected as subcontractors in the second tier. Hence, SME promotion policies, simultaneously, should improve competitiveness of existing non-subcontracting enterprises. Moreover, policies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

Labor-intensive industries in Thailand are losing their competitiveness because of rise in wages. Analysis suggests that labor-intensive industries may shift from

Malaysia and Thailand, where wages are rising, to other countries in the future. Low wages are a factor of international competitiveness in labor-intensive industries, e.g. apparel. Improvements in the business environment from, 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 by increasing competition in international textiles and garment markets following the abolition of the MFA (Multi-fiber Agreement) in January 2005. Similarly, for some countries like India and Philippines, extending benefits to workers engaged in apparel global production networks (GPNs) requires policy attention (Figure 9-1).

Figure 9-1: A framework to analyze SMEs in the age of globalization

External Environment: Globalization – trade and investment liberalization, increasing economic integration through bilateral & regional trading arrangements, regional/global production networks (GPNs)



Source: Aldaba (2008).

(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 labor force and thereby reduce the problems of unemployment.

9.2.3. Cambodia

The majority of Cambodian SMEs are still in a very early stage of development. In 2005, over 80 per cent 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 labor productivity. As globalization deepens, they are struggling to compete with imported goods manufactured by SMEs in neighboring countries. There are three key factors impeding the development of Cambodian SMEs: the country's weak regulatory and legal framework, difficulties faced by SMEs in gaining access to financing, and lack of SME support facilities.

9.2.4. China

SME clusters have been formed in developed coastal areas. Each cluster consists of one or more towns that concentrate 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 to be common. Division of labor 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.

9.2.5. 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 persistent constraints facing the sector, which is 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 the implementation and effect of various small firm policies has been an issue of concern. There has been a definite decline in 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.

9.2.6. Indonesia

Whereas the local content policy did succeed in creating strong interdependence between SMEs and LEs due to the government's excessive interference, private sector-led subcontracting networks arose 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. It was found in the Tegal metalworking industry that a group of entrepreneurs had successfully designed and produced a hand tractor for the domestic market. However, productivity in SMEs is lower than in LEs.

9.2.7. Japan

Japanese SMEs have stood on the crossroads since 1991. Many LEs shifted labor 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 equipments manufacturers changed ways of procurement at three points. They began to procure components from 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.

9.2.8. Lao PDR

Not only is the average wage for the Lao worker lower than that in the neighboring countries, the labor 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 taxes, high inflation, an unstable exchange rate and a lack of investable funds. In the garment industry, FDI provides opportunity for 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 had a negative impact rather than a positive impact on SMEs.

9.2.9. Philippines

A decline in subcontracting ratios was observed in wearing apparel, machinery (except electrical, electrical machinery), and transport industries during 1994 to 2003. This indicates that the local content of the country's leading exports has not only remained low, it has declined substantially. The deepening of high technology industries, such as the electronics and auto parts and components industries, 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 relationships with contractors are product quality, on-time 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.

9.2.10. 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. The financing aspect 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, shortages of qualified human resources and the need to upgrade technology to enhance access to the external market.

9.2.11. Thailand

In the Thai automobile industry before 2000, the transfer of production capabilities was moderately successful, while the more advanced capabilities such as design was relatively limited. Since the abolition of local content requirement policy in 2000 and more liberalized trade policy, many Japanese and U.S. automobile assemblers and auto parts manufacturers have turned Thailand into a major export base for their global operations. The field survey reveals that inter-firm technology transfer has become 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.

9.2.12. Vietnam

SMEs have experienced 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 both of internal and external networking, competitiveness, innovativeness, human resource, and low 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 resources and poor availability of business development services.

9.3. 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 and in the long run they are not even consistent. Therefore, we must develop "best practices" on business environment, subcontracting and networking, and a monitoring mechanism to ensure that SME policies are carried out based on proven policies. Successful case studies invariably indicate that an effective collaboration between the government, trade associations, and educational/training institutes is vitally important to reduce costs for human resource development and to disseminate

information through the effective use of available information and communication technology (ICT).

9.3.1. Networking and clustering

The development of SMEs often requires effective clustering and networking strategies that are developed and made accessible by conscious effective government assistance programs such as industrial incubators, industrial parks for SMEs, and industrial apartment (e.g., *Kojo danchi* 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 is 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 a database of SMEs and set up a forum of SME owners and local governments.

9.3.2. Improving SMEs database

There is a need to both streamline and improve the quality of databases 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.

9.3.3. Enhancing product and process quality

In most Asian countries, to enhance SME competitiveness, efforts must be made to introduce easier provisions for ensuring quality certification. Therefore, it is suggested to establish local and regional product testing and quality standards institutes as a public service for SMEs.

9.3.4. 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 entrants and to create a competitive environment.

9.3.5. 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, governments should encourage trade fairs for procurement to promote subcontracting between MNEs and SMEs. At the trade fairs, MNEs can exhibit components and parts that they are interested in sourcing from SMEs.