EXECUTIVE SUMMARY

ERIA Microdata research FY 2013 examines whether and how globalization has differential effects on small and (or versus) large firms and aims at identifying policy issues to be addressed in order to achieve a more strong and resilient economic growth in East Asian countries. Globalization in this research is broadly defined to include trade and foreign direct investment (FDI) liberalization, trade (exports and imports), international capital flows, outsourcing and traded intermediate goods. The research conducted ten country studies for eight countries in the Asia-Pacific region, namely China, Indonesia, Japan, Korea, Malaysia, Philippines, Thailand, and Vietnam.

Growth performance of many East Asian countries has been far above the international standard. There is a growing consensus that one of the key factors behind it the increasingly integration between these economies with the global market. However, there is also a growing concern that the growth performance has been very uneven across firms; not only in developed countries such as Japan and Korea but also in developing countries such as Indonesia and Vietnam. There seems to be a popular belief that firm performances are divergent, particularly along the dimension of firm size. It is often claimed that the diverging performance is caused by globalization. Compared to large firms, small firms (or SMEs – small and medium enterprises) are at a disadvantageous position to adjust to globalization, among other, but most importantly, in terms of adjustments to an increased import competition, expanded export opportunities, enlarged foreign investment opportunities, and increased global production sharing. The perceived view on the divergence and its possible linkage with globalization, irrespective of the existence of its factual basis, has become an important economic or socio-economic policy issue in many countries. This research attempts to shed some light on these issues.

Key questions raised and addressed in this research include the following, for example, has the performance gap between small and large firms been increasing? are there observable forces that work toward this direction? Does globalization cause firm performance to diverge? if so, what are the specific mechanisms? If not, why? What is the empirical evidence? Where exactly are the market failures in this process? What are the policy measures that are deemed necessary to achieve strong and resilient growth and development?

Existing empirical evidence on the possibly differential effects of globalization on small and large firms are surprisingly rare. Of course, there are numerous empirical studies that examine the possible different firm responses to globalization under the theoretical background of the so-called heterogeneous firm trade theories; however, most of these studies tend to focus not on the size but on other firm characteristics, such as firm productivity or firm's exporting and importing characteristics.

Standard heterogeneous firm trade theories predict that firm's responses to globalization differs according to initial productivity. As in the Melitz model, for example, firm productivity is positively correlated with firm size and also determines firm's initial exporting status. The popular belief that small firms are relatively at a disadvantageous position in respect to globalization is therefore not without some theoretical ground. However, the actual responses of small and (or versus) large firms to globalization could be much more complex those captured by theoretical models. Hence, there might be other important factors which are not understood well enough or left out in the models but still important for to determine firm's responses to globalization.

While not all answer can certainly be answered by this research alone, we believe that the studies in the research are able to provide some new empirical evidence and insights into the relationship between globalization and performance of small and (or versus) large firms. In what follows we expect that all this points out at least some important policy issues which are likely to be necessary to fully appropriate the potential benefits from globalization, and to make growth more stronger and resilient.

Studies in this research show the diverse patterns of relative response of small and large firms. They reveal evidence that small firms are indeed disadvantaged in some aspects of globalization and in the context of some of the countries. In the case of Indonesian manufacturing, for example, the increase in import penetration seems to have reduced the average size of domestic firms. There is however contrary evidence in the case studies of the other countries. Nevertheless, the interesting part of after noting all these evidence is an understanding that there seems to exist some hard-to-ignore tendency that small firms, although they are relatively disadvantaged over large firms in participating in global activities, exhibit larger gains from globalization or grow faster in their productivity than their larger counterparts. This is indicated, for example, by the case studies of manufacturing firms in China and Malaysia where the gap in productivity between larger and smaller firms are fount to have been lowered over the time.

The studies in this project show that the most obvious way to increase the performance of smaller firms is by engaging them in export and maximizing the productivity spillovers by multinationals (MNEs). The latter could take many forms, one of which is direct involvement of smaller firms as suppliers of the MNEs. As uniquely presence in Southeast and East Asia in general, MNEs typically operate either as or in networks of productions with other firms/MNEs in other countries but within the region (i.e., commonly known as the East Asia production networks). As the case study of Thai and Philippines manufacturing show, engagement in supplying to MNEs operating in the production networks proved to be able to increase the growth, survival and productivity of SMEs in these countries.

Meanwhile, engaging in exports evidently is able to increase the productivity performance of SMEs. In fact, exporting seems to be one of the important ways to increase the productivity of smaller firms. As shown in the case study of manufacturing firms in Malaysia for example, engaging in exporting by smaller firms can be explained more by the theory of self-selection rather than by learning by exporting theory. Self-selecting in to exporting arguable requires a firm to do more effort to increase its productivity rather than that implied by learning by exporting theory.

Notwithstanding the evidence on the positive impact of globalization on the performance of smaller firms, it remains a fact that these firms has a scale disadvantage that inherently put them in a different (lower) productivity level than their larger counterparts. Therefore, it is important for government to facilitate smaller firms to be able to read the benefit offered by globalization. In terms of exporting, this can be done by providing assistance or facilitation that reduces the sunk cost of exporting. As shown by one of Japanese country studies, providing information about foreign market through the relation of firms to banks that lend them loans proved to be beneficial in this case. Assistance could also be given more by ensuring conducive the general business environment. This includes the strategy to make investment regime open and be friendly to foreign investors, considering potential positive productivity spillovers coming from MNE activities.

Overall, results of the studies in this project provide useful information for policy makers in respect to managing the impact of globalization on performance of firms and, more importantly, to address the issue of potential diverging effect on the size distribution of firms. The studies convey a message that globalization could indeed improve the performance of smaller firms provided there is a careful policy management, and the policy being managed needs to have a clear objective of maximizing the potential or opportunities from globalization by providing the right and balanced facilitation measures.