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Economic Growth, Development and Integration in East Asia – the role and contribution of SMEs

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OUTLINE OF PRESENTATION

1. OVERVIEW OF ISSUES
2. ROLE AND SIGNIFICANCE OF THE SME SECTOR IN THE ECONOMIES OF EAST ASIA
3. SME CAPACITY BUILDING
4. GOVERNMENT'S ROLE AND SUPPORT FOR SMEs
5. SMEs AND REGIONAL COMPETITIVENESS STRATEGIES
6. CONCLUSIONS AND POLICY IMPLICATIONS

1. OVERVIEW OF ISSUES

GLOBALISATION CHARACTERISTICS AND DRIVERS:

- 1. TRADE LIBERALISATION**
- 2. CAPITAL FLOWS LIBERALISATION
(FDI AND FINANCE)**
- 3. TECHNOLOGY FLOWS AND ADVANCES (ICT AND
PRODUCTION DISCONTINUITIES)**
- 4. FLOWS OF KNOWLEDGE AND IDEAS**
- 5. FLOWS OF LABOUR (SKILLED)**
- 6. TRANSPORTATION ADVANCES AND COSTS**

SMEs AND GLOBALISATION

CHALLENGES

- LACK RESOURCES (FINANCE, TECHNOLOGY, SKILLED LABOUR, ACCESS TO MARKETS, INFORMATION)
- LACK ECONOMIES OF SCALE AND SCOPE
- FACE HIGHER TRANSACTION COSTS
- LACK OF INFORMATION, KNOWLEDGE AND EXPERIENCE IN INTERNATIONAL MARKETS
- MARKET STRUCTURE (GREATER CONCENTRATION)
- CANNOT COMPETE AGAINST LARGER FIRMS (R&D AND INNOVATION)

Why then are there so many SMEs?

OPPORTUNITIES

- NICHE MARKETS (CUSTOMISATION)
- DISCONTINUITIES IN PRODUCTION (TECHNOLOGY)
- REDUCED PRODUCT LIFE CYCLES (FLEXIBILITY MORE IMPORTANT THAN VOLUME)
- GLOBAL PRODUCTION SYSTEM (CORE BUSINESS AND 'SUBCONTRACTING')
- GLOBAL RETAIL SOURCING – 'PUTTING OUT'
- GROWTH OF SERVICE SECTOR (RISING AFFLUENCE IN POST INDUSTRIAL SOCIETIES)
- IMPORTANCE OF KNOWLEDGE/SKILLS RATHER THAN VOLUME IN THE NEW ECONOMY (COMPETITIVENESS)

- **REDUCED BUREAUCRACY AND GREATER FLEXIBILITY TO CHANGING CUSTOMER DEMANDS**
- **INNOVATION (KNOWLEDGE SKILL INTENSIVE, LOWER ENTRY COSTS)**
- **E-COMMERCE (EXPANDED MARKET REACH AND INFORMATION)**
- **CLUSTERING AND NETWORKING**
- **TECHNOLOGY DEVELOPMENT, ADAPTATION AND APPLICATION (FLEXIBILITY)**
- **RECOGNITION BY POLICY MAKERS (DEVELOPING ECONOMIES)**

THEORY – FIRM SIZE DISTRIBUTION

KEY FACTORS:

1. TECHNOLOGY BASED ECONOMIES OF SCALE
2. RESOURCE ENDOWMENTS
3. TRANSACTION COSTS (COASE, 1938)
4. MARKET STRUCTURE/COMPETITION
5. CONSUMER/MARKET DEMAND
6. STAGE OF DEVELOPMENT

SME CONTRIBUTION TO ECONOMIC DEVELOPMENT AND GROWTH FROM THE LITERATURE

- > GROWTH/OUTPUT**
- > EMPLOYMENT**
- > EXPORTS**
- > POVERTY ALLEVIATION**
- > ECONOMIC EMPOWERMENT**
- > INCOME AND WEALTH DISTRIBUTION**

> REGIONAL DEVELOPMENT

> NETWORKING AND CLUSTERING (SOURCE
OF COMPETITIVENESS IN
DEVELOPED/DEVELOPING ECONOMY)

2. ROLE AND SIGNIFICANCE OF THE SME SECTOR IN THE ECONOMIES OF EAST ASIA

- > NUMBERS (Tables 1, 2)**
- > EMPLOYMENT (Table 3, 4)**
- > OUTPUT/VALUE ADDED (Table 5)**
- > EXPORTS (Table 6)**
- > FDI**

TABLE 1:
Number of Private Non-Agricultural SMEs as a
Percentage of Firms, Selected APEC Countries
(%), 1999

	<i>Micro (<5 employees)</i>	<i>Small (5-19 employees)</i>	<i>Medium (20-99 employees)</i>	<i>All SMEs</i>
Australia	69.9	24.3	4.9	99.0
Chile	82.1	15.0	2.1	99.1
Hong Kong, China	86.8	7.6	4.9	99.3
Japan	56.5	34.7	7.4	98.7
Korea	72.7	17.8	8.6	99.1
Mexico	91.7	6.3	1.6	99.6
New Zealand	84.2	7.1	8.0	99.4
Peru	96.5	3.1	0.3	99.9
Philippines	91.1	8.2	0.4	99.6
Singapore	67.4	24.3	6.1	97.8
Thailand	79.0	18.4	2.0	99.4
USA	60.5	28.9	8.9	98.3

Source: Hall (2002)

TABLE 3:
Contribution of Micro, Small and Medium Sized
Enterprises to Private Non-Agricultural Employment,
Selected APEC Countries (%), 1999

	<i>Micro</i> (<i><5</i> <i>employees</i>)	<i>Small</i> (<i>5-19</i> <i>employees</i>)	<i>Medium</i> (<i>20-99</i> <i>employees</i>)	<i>All SMEs</i>
Australia	25.9	20.9	19.2	66.0
Hong Kong, China	31.1	13.0	24.8	59.4
Japan	13.1	29.9	26.9	69.9
Korea	31.2	11.3	36.2	78.7
Mexico	36.2	13.9	15.2	65.2
New Zealand	23.0	18.0	19.0	60.0
Peru	62.5	16.6	8.8	87.9
Philippines	36.7	25.8	7.1	69.5
Singapore	7.1	16.8	19.2	43.1
USA	5.2	13.6	17.9	36.7

Source: Hall (2002)

Table 8 provides a summary of key common features, differences and policy issues, in the profile of SMEs in East Asia discussed in this section.

Table 8 A Summary Profile of SMEs in East Asia/APEC

	Key features	Regional differences and policy issues
Numbers of Enterprises	<p>1. There are about 20 to 30 million SMEs in East Asia.</p> <p>2. They account for 98% of all enterprises.</p> <p>3. Micro-enterprises account for about 73% of all private sector enterprises.</p> <p>4. On average there are about 85 people for every SME.</p>	<p>1. Most of the SMEs are in China (8 million) and Japan (5 million) and Korea (2.6 million) which together have 70% of the SMEs in East Asia.</p> <p>2. In developed economies there are only about 20 people per SME, but the ratio is above 100 in the developing economies, especially in China, Vietnam, Philippines and Indonesia.</p>
Employment	<p>5. SMEs employ about 60% of the private sector workforce, and 30% of the total workforce.</p> <p>6. Micro-enterprises employ about 21% of total APEC wide employment.</p> <p>7. Over 95% of enterprises employ less than 100 people, and over 80% employ less than 5 people.</p> <p>8. SMEs contribute about 70% of net employment growth.</p> <p>9. SMEs provide about 80% of employment in the services sector, and about 15% in the manufacturing sector.</p> <p>10. Women make up about 30% of employers/self employed in APEC – mainly in micro-enterprises</p>	<p>3. In developing economies (below about \$15,000 USD per head income) SMEs employ about 75% of people, above \$15,000 the level is closer to 50%. Japan is a major exception - Japan's SMEs employ around 80% of the workforce.</p> <p>4. More developed economies seem to have more medium sized SMEs and they play a greater role. Developing economies seem more likely to have a "missing middle".</p> <p>5. In developed economies most of this growth probably comes from fast growth firms, in developing economies a higher proportion probably comes from net start ups.</p>

Output measures (sales, value added etc)	11. SMEs contribute about 50% of sales, value added or output.	6. The contribution varies from lows of 15% (Singapore) and 30% (Australia) to about 60% for most other economies.
Exports	12. SMEs generate about 30% of direct exports (US\$930 billion in 2000), much less than the SME contribution to employment (about 60% to 70%) or output (about 50%). 13. SMEs contribute indirectly to trade through supply chain relationships with other firms. SME contribution to total trade could rise to 50%.	7. SME exports figures are difficult to verify, but they range from about 5% or less (Indonesia) to around 40% (Korea) of total exports. 8. Tariff cuts have increased total APEC member trade, but the SME contribution to direct exports has remained static or declined. Reductions in tariffs have not benefited SMEs, more emphasis needs to be put on tackling non tariff barriers if SMEs are to benefit from trade expansion.
FDI	14. SMEs generate about 50% of cases of FDI, but only less than 10% of value of FDI.	9. Korean, Japanese and Chinese Taipei SMEs contribute most FDI originating in the East Asian region.
Entrepreneurial Engine, international potential, and the new economy.	15. SMEs already contribute the bulk of growth, and SMEs could make a much bigger contribution to the Asian regional economy if efforts were made to address impediments to SME internationalization. This could add as much as \$1.18 trillion in trade over a 5 year period. 16. SMEs moving towards services and away from agriculture and manufacturing.	10. The developing economies need to create about 50 to 70 million more SMEs if they are to achieve “benchmark” levels of SME activity. 11. To achieve maximum gain from trade it is essential to improve governance, building capacity, reducing transaction costs, promoting further liberalization, addressing non tariff barriers, increasing internet access and facilitating trade and investment to improve the capacity of SMEs to export. 12. Capacity building includes: access to finance; improved professional skills (IT, management, accounting and entrepreneurship); improved business infrastructure; removal of trade barriers that particularly adversely affect SMEs. 13. E-commerce use of SMEs lags larger enterprises. Important for cost saving and growth potential. Usage of technology a problem due to: set up and usage costs; lack of adequate infrastructure and IT skills.

Source: Hall (2002) supplemented by information from APEC (2002)

KEY POINTS (Table 8)

- > **THE REGION HAS A SIGNIFICANT, SIZEABLE AND RAPIDLY EXPANDING SME SECTOR**
- > **THE SME SECTOR CONTRIBUTION VARIES BY COUNTRY AND DEPENDS ON:**
 - STAGE OF ECONOMIC DEVELOPMENT**
 - COUNTRY INSTITUTIONS**
 - NATURE AND EXTENT OF DOMESTIC ENTREPRENEURIALISM AND INNOVATION**
 - EXTENT OF MARKET OPENING AND COMPETITIVENESS**
 - ACCESS TO TECHNOLOGY**
 - ACCESS TO FINANCE**

DEVELOPMENT OF HUMAN RESOURCES

ACCESS TO MARKET INFORMATION

ABILITY TO EXPLOIT EXPORT OPPORTUNITIES EITHER DIRECTLY OR AS PART OF THE SUPPLY CHAIN OF MNCS

MARKET FRIENDLY AND SUPPORTIVE GOVERNMENT POLICIES

> CLEAR REGIONAL TRENDS TOWARDS GLOBALISATION AND INCREASED REGIONAL INTEGRATION

> IMPORTANT TO FULLY EXPLOIT EXPORT POTENTIAL OF SMES (ICT AND REDUCED TRADE BARRIERS)

SMES AS THE ENTREPRENEURIAL ENGINE OF EAST ASIA

1. SMEs PROVIDE THE LION'S SHARE OF GROWTH (70 PER CENT OF EMPLOYMENT GROWTH). ALMOST ALL NET EMPLOYMENT CREATION IN CHINA, VIETNAM AND INDONESIA IN THE LAST 5-10 YEARS HAS BEEN IN SMES. LARGE FIRMS HAVE BEEN NET JOB LOSERS AS THEY DOWNSIZE.

2. THE ENTREPRENEURIAL ENGINE IS UNDER-POWERED (CHINA, INDONESIA, PHILIPPINES, THAILAND AND VIETNAM (SEE TABLE 7)

70 MILLION MORE ENTERPRISES REQUIRED
MANAGERIAL SKILLS AND TRAINING. HUGE POTENTIAL
FOR SME START UPS IN CHINA, INDONESIA AND
VIETNAM
MAJOR SOURCE OF FUTURE JOBS AND ECONOMIC
GROWTH

**TABLE 7:
SME intensity in developing East Asia
(millions and ratio)**

	population	estimated number of SMEs now	benchmark SMEs if ratio is 20 people per SME	Additional SMEs needed to meet benchmark
China	1244.2	8.0	62.2	54.2
Indonesia	203.4	2.0	10.2	8.2
Philippines	71.4	0.5	3.6	3.1
Thailand	59.7	0.67	3.0	2.3
Vietnam	76.5	0.5	3.8	3.3
Totals	1655.2	11.7	82.8	71.1

Source Hall (2002)

3. NET START-UPS WILL CONTRIBUTE THE BULK OF THE CONTRIBUTION TO GROWTH IN DEVELOPING EAST ASIA. IN DEVELOPED EAST ASIA THE BULK OF THE GROWTH CONTRIBUTION WILL COME FROM HIGH GROWTH FIRMS

4. THE SME ENTREPRENEURIAL ENGINE IS BEING INTERNATIONALISED. JAPAN, KOREA AND TAIWAN LABOUR INTENSIVE SMES HAVE EXPANDED OPERATIONS OVERSEAS IN EAST ASIA (ICT, E-COMMERCE, TECHNOLOGY AND SOCIAL CHANGES)

CROSS COUNTRY COMPARISONS – A CAVEAT

SUCH COMPARISONS SHOULD TAKE INTO CONSIDERATION COUNTRY DIFFERENCES IN:

- RESOURCES/ENDOWMENTS
- ECONOMIC STRUCTURE
- STAGE OF DEVELOPMENT
- INSTITUTIONS (GOVERNMENT AND MARKET)
- CULTURE
- HISTORY
- HETEROGENEITY OF THE SME SECTOR ITSELF (Table A)

T A B L E A : P r i v a t e S M E c h a r a c t e r i s t i c s

C h a r a c t e r i s t i c	A c t u a l	D e s i r e d
Type of business activity	Agriculture, industry - Low value adding, low skill low growth, low income	H i t e c h , m a n u f a c t u r i n g , s e r v i c e s - H i g h v a l u e a d d i n g , h i g h s k i l l h i g h g r o w t h , h i g h i n c o m e
Business size	Sole Micro	Small Medium
Business objectives	Livelihood No Growth, Lifestyle	G r o w t h o r i e n t e d
Macro-economy	Developing/Poor	A d v a n c e d / R i c h
Institutions	Elementary	A d v a n c e d
Business Development (Advisory) Services	Elementary	A d v a n c e d
Standing	Informal	F o r m a l
Location	Rural	Urban
Growth source	New start-ups	Growth of existing enterprises (high growth enterprises)
Market demand	Local Regional	National I n t e r n a t i o n a l
Owner - income/wealth	Very poor	Wealthy
Ownership type	Community/cooperative/state	Private
Gender	Female/male	Female/male
Owner entrepreneurship/ education/business skills	Basic	S o p h i s t i c a t e d
Standards - technical, environmental, labour	Low	H i g h
Capital	Own savings, relatives - Microfinance/ MFI	B a n k c r e d i t V e n t u r e c a p i t a l P r i v a t e e q u i t y
Technology (inc. e- commerce)	Weak/basic	S o p h i s t i c a t e d
Innovation (product, process and technology) mechanisms	Basic	A d v a n c e d
Supply chain/FDI activity	None	M N C s O t h e r S M E s
Networking, clusters, business associations participation	Inactive	A c t i v e

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3. BARRIERS TO SME DEVELOPMENT AND KEY AREAS FOR CAPACITY BUILDING

GENERAL BARRIERS:

ACCESS TO MARKETS

ACCESS TO TECHNOLOGY

ACCESS TO HUMAN RESOURCES

ACCESS TO FINANCING

ACCESS TO INFORMATION

INTER-FIRM NETWORKING

INNOVATION

SPECIFIC BARRIERS TO DEVELOPING/TRANSITIONAL ECONOMIES

TABLE B

A Summary of Impediments to SME development in East Asia

1. Access to land
2. Access to finance (supply and demand factors) – high risk (risk premium) and high transactions cost. Lack of instruments for managing risk. SME lending institutions strengthened
3. Compliance costs (administrative/regulation costs)
4. Legal framework (lacking in transparency, intellectual property rights, enforcement of contracts, bankruptcy, no basic SME Law)
5. Access to technology (availability and cost, computers, internet, e-commerce)
6. Access to information on business opportunities
7. Access to markets (e.g. government procurement)
8. Access to Business Development Support (Advisory) Services (accounting, consulting, marketing services)
9. International competitiveness – lack economies of scale
10. Relatively high transaction costs – transport infrastructure and transport costs
11. Accreditation costs – to achieve technical, labour and environmental standards (ISO9000, ISO14000 etc.)
12. Market failure
13. Fairness, transparency and consistency in the taxation of private firms
14. Access to skilled human resources
15. Entrepreneurial skills and training
16. Societal attitudes
17. Lack of, and cost of, infrastructure
18. Costs of becoming formal rather than remaining informal
19. Discrimination – pro big business approach, corruption, no SME Ministry or government department

SME CAPACITY BUILDING

TRADITIONAL APPROACH TO SME DEVELOPMENT HAS FOCUSED UPON THE PROVISION OF CREDIT FINANCE. PROVED INEFFECTIVE

NOW MORE MARKET BASED APPROACH IN AN APPROPRIATE POLICY ENVIRONMENT, PROMOTE COMPETITIVENESS, WITH STRONGER FINANCIAL INSTITUTIONS , WITH BUSINESS ADVISORY SERVICES AND EQUITY AND VENTURE CAPITAL MARKETS

SMES MUST DEVELOP CAPACITIES TO BECOME COMPETITIVE IN GLOBAL MARKETS (BENEFIT FROM GLOBALISATION)

THESE INCLUDE:

- > IMPROVE GOVERNANCE**
- > REDUCE TRANSACTION COSTS**
- > BUILD UPON THEIR STRENGTHS (ENTREPRENEURIAL SPIRIT, FLEXIBILITY, RESOURCEFULNESS, DEVELOPMENT OF MARKET NICHEs BASED ON UNIQUE PRODUCTS AND SERVICES)**
- > PARTICIPATE IN VALUE ADDING GLOBAL SUPPLY CHAINS**
- > TAKE ADVANTAGE OF THE PROCESS OF PRODUCT FRAGMENTATION**
- > INCREASE THEIR R&D AND LEVEL OF INNOVATION**
- > PARTICIPATE IN NETWORKING BOTH IN THE DOMESTIC ECONOMY AND INTERNATIONALLY**
- > UPGRADE THEIR TECHNOLOGY AND SKILLS AND MAKE GREATER USAGE OF E-COMMERCE**

GOVERNMENT CAN ASSIST THIS BY:

- > PROMOTING FURTHER MARKET LIBERALISATION AND MARKET ACCESS**
- > ADDRESSING NON-TARIFF BARRIERS**
- > INCREASE INTERNET ACCESS AND INFRASTRUCTURE**
- > PROVIDE TRAINING PROGRAMS**
- > PROVIDE MORE MARKET INFORMATION**
- > FACILITATE BUSINESS NETWORKING**
- > PROTECTING INTELLECTUAL PROPERTY RIGHTS**
- > TACKLING FACTORS THAT DISCRIMINATE AGAINST SMEs (EXCESSIVE COMPLIANCE COSTS ETC.)**

**SME CAPACITY BUILDING – APEC AGENDA
OTTAWA 1997, FIVE KEY AREAS OF IMPORTANCE**

- 1. ACCESS TO MARKETS
TAKE ADVANTAGE OF MORE OPEN REGIONAL TRADING AND
INVESTMENT ENVIRONMENT
INTERNET SEEN AS IMPORTANT
SME TRADING PERFORMANCE DISAPPOINTING DESPITE
TARIFF CUTS
NON-TARIFF IMPEDIMENTS SEEN AS MORE IMPORTANT:

CUSTOMS PROCEDURES

MOBILITY OF BUSINESS PEOPLE
STANDARDS OF LABELING REQUIREMENTS

ACCESS TO FINANCE

RECOGNITION OF PROFESSIONAL QUALIFICATIONS**



CONSUMER PROTECTION (ON-LINE TRANSACTIONS)

INTELLECTUAL PROPERTY RIGHTS

BENEFITS FROM EXPANDED SME TRADE

ECONOMIES OF SCALE

ACQUIRE NEW SKILLS, NEW TECHNOLOGY AND NEW MARKETING TECHNIQUES

EXPORTERS APPLY KNOWLEDGE AND TECHNOLOGIES AT A FASTER RATE AND MORE INNOVATIVELY THAN NON-EXPORTERS GREATER EFFICIENCY AND PRODUCTIVITY

MANY SME EXPORTERS SPREAD SKILL AND TECHNOLOGY APPLICATIONS OVER MANY SMALL BUYERS BENEFITING THE WHOLE ECONOMY

EXPORTING HAS POSITIVE EFFECTS ON LIVING STANDARDS COMPETITION DRIVES FIRMS TO INVEST IN STAFF DEVELOPMENT – IMPROVING PRODUCTIVITY, WAGES AND WORKING CONDITIONS

2. ACCESS TO TECHNOLOGY

ICT IMPORTANT IN A KNOWLEDGE BASED ECONOMY

OFFSETS SIZE DISADVANTAGES FACED BY SMES (ACCESS TO MARKETS, COST SAVINGS)

HOWEVER SMES LAGGING BEHIND LARGE ENTERPRISES IN E-COMMERCE USAGE

3. ACCESS TO HUMAN RESOURCES

TRAINING/EDUCATION IN BUSINESS SKILLS
SKILLED LABOUR IN IT

4. ACCESS TO FINANCING

5. ACCESS TO INFORMATION

> MARKET OPPORTUNITIES
> FINANCIAL ASSISTANCE
> TECHNOLOGY

ADDITIONAL KEY AREAS FOR CAPACITY BUILDING

6. INTER-FIRM NETWORKING

BASIS FOR DEVELOPING POTENTIAL INDUSTRIAL CLUSTERS

7. INNOVATION

SMES HAVE THE POTENTIAL TO BE INNOVATIVE IN PRODUCTION PROCESSES, PRODUCT DESIGN AND IN THE ADOPTION OF NEW TECHNOLOGY

4. ROLE OF GOVERNMENT

- **A CONTROVERSIAL ISSUE!**
- **SHOULD GOVERNMENT ATTEMPT TO INFLUENCE THE SIZE DISTRIBUTION OF ENTERPRISES IN THE ECONOMY AND WITHIN SPECIFIC SECTORS?**
- **TRADITIONAL POLICIES IN SUPPORT OF SMES CAN BE CATEGORISED ACCORDING TO THEIR OBJECTIVES (SEE TABLE C)**
- **MANY OF THESE HAVE BEEN CRITICISED (REVESZ AND LATTIMORE (1997), HALLBERG (2000), LEVITSKY (1996), STOREY (1982), LATTIMORE, MADGE, MARTIN ND MILLS (1998))**

Table C Categories of SME Support Policies

Macro objectives	<ul style="list-style-type: none"> • Creation of employment • Economic development • Export growth
Social objectives	<ul style="list-style-type: none"> • Income redistribution • Poverty alleviation in developing countries
Correction of Market failure/inefficiency (static efficiency objectives)	<ul style="list-style-type: none"> • Presence of externalities • Market access barriers • Asymmetric information • Small number of competitors • Information imperfection (lack of access to information about potential markets) • Levelling the playing field
Dynamic efficiency objectives	<ul style="list-style-type: none"> • Promotion of innovation

Source: Harvie and Lee (2005).

EVIDENCE FROM THE LITERATURE

Macroeconomic objectives

There is little evidence from the literature to suggest that SMEs are better able to create employment than large enterprises.

SMEs are not necessarily more labour intensive. This will depend more on the industry sector of operation of the enterprise than the size of the enterprise per se.

There is considerable 'churning' in the SME sector with considerable job creation and destruction.

- The 'quality of jobs' created by SMEs may be poorer than that by large enterprises

The contribution of SMEs to economic development will change with the stage of economic development.

SMEs face major problems and barriers when it comes to exporting.

Literature is ambiguous on the importance of business size for innovation.

Social objectives

Using SMEs as a tool for income distribution may be ineffective. Those SMEs owners that are recipients of government assistance are unlikely to be the poorest of the poor, or the most disadvantaged

The tax system is likely to be a more effective means of achieving greater income equality

Poverty alleviation/economic empowerment through small business development can have a role as demonstrated by the micro finance literature relating to the development of micro enterprises in poor developing economies (e.g. Grameen Bank in Bangladesh)

Market oriented approach

Government should not use selective measures to influence the size distribution of firms in an industry or in the economy

Firm size distribution depends upon:

- Resource endowments**
- Technology based economies of scale**
- Transaction costs**
- Market structure and market segmentation**
- Consumption patterns**
- Stage of development**

Some of these (resource endowments, technology and consumption patterns) are 'natural' determinants of firm size and firm size distribution

Government intervention in such circumstances would not be warranted

Such a market oriented approach to policy, only advocates intervention by government where there are clear market failures

A levelling of the playing field approach is adopted

Dynamic efficiency objectives and the promotion of innovation

Increasing focus on the importance of dynamic efficiency as an objective of policy

Competition policy increasingly recognised as a vital element of the framework for a dynamic market economy

Dynamic efficiency is concerned with technological innovations enhancing welfare, and refers to “the use of resources so as to make timely changes to technology and products in response to changes in consumer tastes and productive opportunities”

In a dynamic economy competition in product and process innovations may have a more significant effect on welfare, at least in the long run, than does any likely variation in price.

The conceptual underpinnings linking competition to dynamic efficiency or innovation are provided by Porter (1990), who argues that “healthy competition” is essential to delivering ongoing innovations in products, processes and methods, which in turn are critical to a country’s prosperity.

The available research on the relative innovativeness of small versus large firms has been inconclusive despite extensive research into this issue since the 1950s.

Policies intended to encourage R&D activities in all firms regardless of their size, through grants and subsidies, therefore seem appropriate in this context

The evidence would seem to suggest that it is technological opportunities, rather than firm size, that explain firm innovativeness

However, it is generally accepted that smaller firms, because of their relatively low levels of employment of technical specialists, are disadvantaged relative to large firms in a number of areas, including establishing communication with external sources of scientific and technological expertise and knowledge.

Table D summarises some of the key elements of a facilitatory or 'market oriented approach' role by government

**Table D Summary – Role of Government
Key ingredients**

Macroeconomic environment	Microeconomic environment
1. Economic stability	1. Simplified legal/regulatory systems
2. Low budget deficits	2. Low compliance costs and regulatory burden (administrative costs). Facilitate firm start-ups and expansion
3. Low inflation	3. Low formalising costs (easy and transparent firm registration, business licensing requirements minimised, and tax costs))
4. Pro business environment	4. Competition policy - continue and speed up ongoing markets reforms and deregulation
5. Stable/competitive exchange rate	5. Good corporate governance (transparency and corruption)
6. Openness to trade. Trade negotiations and reducing trade barriers (ASEAN, WTO) – tariff and non tariff barriers	6. Absence of corruption (transaction costs)
7. Economic integration	7. Access to finance (use of SME assets as collateral (land and land use rights), venture capital, equity markets, stronger financing institutions). Strengthening financial intermediaries that lend to small business
8. Openness to FDI	8. Government procurement policy
9. Broad National Development and Poverty Strategy, embedding strategies for the private sector and SMEs (SEDS).	9. Provision of suitable infrastructure – communications, transport and utilities. With globalisation ICT infrastructure very important (virtual clusters).
10. Education/training and health system	10. Skilled workforce
	11. Level playing field treatment of all enterprises
	12. Tackle market failures (barriers to entry)
	13. Encourage and facilitate the growth of private business development (advisory services)

	14. Promote the role and contribution of entrepreneurship in society
	15. Establish multi-sector ownership
	16. Develop an institutional environment where contracts are enforced and property rights established and clear
	17. Legislation and regulation gender insensitive
	18. Land/bankruptcy legislation that ensures access to land for SMEs and clear land use rights, and eliminates unduly high penalties on entrepreneurs and lenders arising from SME failure. Market exit should be made easy.
	19. Encourage the establishment of industry organisations that will represent the interests of members and provide market information.
	20. Encourage networks, and clusters of international, national and local level small firms.

5. SMEs AND REGIONAL COMPETITIVENESS STRATEGIES

DURING THE EARLY STAGE OF DEVELOPMENT SME COMPETITIVENESS IS PRIMARILY BASED ON LOW LABOUR COSTS AND OPERATING IN LOW VALUE ADDING, LOW INCOME AND LOW SKILL SECTORS

WITH DEVELOPMENT AND GLOBALISATION HAS COME THE NEED FOR SMES TO CREATE, ACCESS AND COMMERCIALISE KNOWLEDGE ON GLOBAL MARKETS.

THIS WILL BE THE KEY SOURCE OF FUTURE COMPETITIVENESS IN GLOBAL MARKETS

SOME OF THE COMPETITIVENESS STRATEGIES USED BY INNOVATIVE SMES IN THE DEVELOPED ECONOMIES INCLUDE THE FOLLOWING:

Innovation strategy, in which SMEs try to appropriate returns from their knowledge base (which may or may not involve own investments in R&D).

Information technology strategy, which makes innovative uses of information technology in order to reduce SME costs and increase productivity.

Niche strategy, in which SMEs choose to become sophisticated global players in a narrow product line.

Network strategy, in which SMEs work and co-operate with other firms, be they SMEs or large enterprises, in order to improve their ability to access and absorb innovations.

Cluster strategy, in which SMEs locate in close proximity with competitors in order to take advantage of knowledge spill-overs, especially in the early stages of the industrial lifecycle (OECD (2000b)).

Foreign direct investment strategy, in which SMEs exploit firm specific ownership advantages overseas.

Supply chain strategy, where SMEs attempt to take advantage of TNC outsourcing ('putting out' or 'subcontracting'), arising from the fragmentation of production or global sourcing, by linking in to the supply chain of large companies. This can enable access to technology and new management skills, however it also requires SMEs to achieve the level of technology, quality and reliability of supply demanded by large companies.

CLUSTER AND INTER-FIRM NETWORKING STRATEGY

CAN ENHANCE PRODUCTIVITY, RATE OF INNOVATION AND COMPETITIVE PERFORMANCE OF FIRMS

CONTRIBUTE TO KNOWLEDGE SPILLOVERS

ALLOW SMALL FIRMS TO COMBINE THE ADVANTAGES OF SMALL SCALE (FLEXIBILITY) WITH THE BENEFITS OF LARGE SCALE (ECONOMIES OF SCALE)

FACILITATE COLLABORATION (MARKETING, MUTUAL CREDIT GUARANTEE ASSOCIATIONS, JOINT DESIGN, SPONSORSHIP OF TRAINING)

MORE EFFICIENT DISTRIBUTION OF LABOUR AMONG FIRMS

INTER-FIRM NETWORKS ALLOW FIRMS TO COMPETE ON A PAR WITH LARGER ENTERPRISES

NETWORKS FACILITATE LEARNING

RECONFIGURATION OF RELATIONSHIPS WITH SUPPLIERS

INCREASED EFFICIENCY THROUGH COLLECTIVE ACTION

ENCOURAGE GREATER SPECIALISATION AMONG SMALL FIRMS (ECONOMIES OF SCOPE AND SCALE)

NETWORKING IS CENTRAL TO THE COMPETITIVE ADVANTAGE DERIVED FROM MEMBERSHIP OF A CLUSTER (GEOGRAPHICAL PROXIMITY IMPORTANT FOR CONVEYING KNOWLEDGE (NON CODIFIED INFORMATION))

6. CONCLUSIONS AND POLICY IMPLICATIONS

SMEs PLAY AN IMPORTANT ROLE IN MANY ECONOMIES IN EAST ASIA

SMEs PROVIDE THE ENTREPRENEURIAL ENGINE FOR EAST ASIA BUT IS UNDERPOWERED IN SOME COUNTRIES

SMEs HAVE GREAT OPPORTUNITIES TO ENGAGE IN EXPORTING BUT ARE SUBJECT TO BARRIERS SPECIFIC TO THEIR SMALL SIZE

SMEs ARE GAINING MORE INFLUENCE IN REGIONAL ECONOMIES

THEIR FUTURE SUCCESS DEPENDS ON BUILDING UP THEIR CAPACITY TO TAKE ADVANTAGE OF MARKET OPPORTUNITIES

REGIONS WITHIN COUNTRIES HAVE BECOME MORE IMPORTANT WITH GLOBALISATION – CLUSTERING AND NETWORKING ARE KEY SOURCES OF COMPETITIVE ADVANTAGE FOR SMEs

**ADOPTION OF AN SME INDUSTRY POLICY DOES NOT
APPEAR TO BE JUSTIFIED FROM THE LITERATURE**

**MEASURES TO ASSIST SMEs SHOULD BE BASED
SOLELY ON GROUNDS OF MARKET FAILURE**

**POLICY MEASURES SHOULD BE EVALUATED
CAREFULLY TO ENSURE THAT THERE ARE OVERALL
BENEFITS FROM THEM**

**THE ROLE OF GOVERNMENT AS A FACILITATOR AND
ACHIEVER OF A LEVEL PLAYING FIELD FOR
BUSINESS SHOULD BE EMPHASISED**



**THANK YOU FOR YOUR
ATTENTION**