CHAPTER II
Contributions, challenges and prospects of SMEs

A. What does SME development mean?

Most people have a broad sense of what constitutes an SME, if only a rather stereotypical image of a young and relatively fragile business. There is a temptation to liken SMEs to the student generation of the corporate community, containing considerable growth potential if only their energy and enthusiasm can be harnessed and channelled in the right direction. Whereas some SMEs will go on to great things in later life, many will probably achieve more modest goals and sadly most will come to a premature end for one reason or another (Shane, 2008).

SMEs constitute the vast majority of company registrations in any economy, and there is the expectation that an elite few will make the leap "from garage to great". There is also a tendency to believe that a vibrant SME sector helps promote competition and a culture of entrepreneurship, which are both conducive to economic growth. SMEs, especially new small enterprises, help create dynamic efficiencies, are often seen as being nimble and agile in nature and more willing to innovate than their larger and more well-established peers (ADB, 2009). While some of this is true, the picture of SMEs needs to be more detailed if effective policies are to be created. Many SMEs, labouring under severe financial and human resources constraints, are less knowledgeable than their larger competitors. They are, in fact, less likely to access markets or to innovate (Shane, 2008). The potential exists for SMEs to enhance competition and to create new technologies, but only if the environment in which they operate nurtures such development. In the best-case scenario, some of the more innovative and dynamic SMEs can serve as catalysts in transforming developing economies in various structural ways, including advances up the value chain.

For developing and transitional economies[10] in particular, SME development holds the added allure of being a key component of wider economic development and poverty alleviation, by providing a safety net to society. In developing countries, SMEs can serve as a useful bridgehead between the informal economy of family enterprise and the formalized corporate sector. Some SMEs may also be a source of foreign exchange earnings if they are able to meet the quality and quantity standards required to export their products or services overseas (ESCAP, 2009a). In the case of transitional economies, SME development is broadly synonymous with private sector development, although many state-owned enterprises can also be SMEs. The SME community is seen as a major and sustainable generator of employment and income for citizens (and therefore tax revenues) working outside of the state sector.

[10] Those countries typically undertake all or some of development strategies based on: (a) primary sector (e.g., agribusiness); (b) natural endowment; (c) exports and FDI promotion; and (e) process improvement.

In the field of SME development, policymakers in Asia and the Pacific face the following challenges:

(a) Scattered targets leading to high transaction costs;
(b) Lack of economies of scale;
(c) Limited public resources;
(d) Limited understanding about the targets, i.e., SMEs;
(e) Limited communication channels; and
(f) Limited knowledge and skills.

The objectives of policymaking include:

(a) Increase the number of start-ups;
(b) Increase their survival rate;
(c) Encourage incorporation or formalization;
(d) Foster SME graduates (to be large enterprises);
(e) Facilitate the smooth exit of failed firms, with leniency for bankruptcy;
(f) Enhance access to markets (e.g., increased exports and exporting to wider markets); and
(g) Sustainable and inclusive enterprise development (e.g., environment, gender, youth and minorities).

B. Definition of SMEs

Definitions of what constitutes an SME vary quite widely from country to country and even within single countries, depending on the business sector concerned – e.g., agriculture, natural resources, manufacturing, services and retailing (ESCAP, 2009a). There is no universal determinant of or criterion for an SME. Much depends on the character of the respective host country, and the profile of its own particular corporate sector, from which a relative measure of an SME is then typically made, sometimes on a rather arbitrary basis.

The form of ownership profile, type of legal entity or general provenance of the company is typically deemed irrelevant when creating the definition. While an SME is often imagined as a locally-owned and privately-held business, there is no reason why it cannot be a state-owned or foreign-invested enterprise. Some countries will distinguish between a microenterprise and a small enterprise, while others – by not setting a limit for SME size – effectively include micro-enterprises within their SME umbrella definition. The above notwithstanding, most SME definitions pertain to businesses that are formal in nature and have been registered in some manner, and exclude small-scale, informal family enterprises (ESCAP, 2009b).

According to a World Bank study, more than 60 definitions of SMEs are used in 75 countries (Indian Institute of Foreign Trade, 2011). Some countries have used the number of employees as the sole criteria for determining whether a business is an

SME or not. Other countries use this same criterion, plus an additional one based on either the value of the firm's assets or the size of revenue in local currency. In cases where a currency value is cited (either for assets or revenues) any marked inflation can pose a problem for the SME definition over time. Some countries recognize this issue and occasionally update their criteria for SMEs, but most do not (ESCAP, 2009a). The three main parameters that have been generally applied to define SMEs are: (a) the number of employees; (b) turnover of business; and (c) capital investment.

Table II.1. Indicators used among international, regional and local sources

Indicator	International	Regional	Local
Number of employees	✓✓✓	✓✓✓✓✓✓	✓✓✓✓✓
Annual sales	✓✓		✓✓✓✓
Registered capital		✓	✓
Total assets	✓✓		✓✓
Total credit facilities[11]			✓✓✓✓✓
Qualitative indicators[12]	✓		✓

Source: USAID, 2007.

Table II.1 illustrates the prevalence of indicators according to a United States Agency for International Development (USAID) (2007) booklet on SME definition. While this publication specifically aimed at providing an applicable definition for the Hashemite Kingdom of Jordan, it contains common patterns and lessons that can be extrapolated to other nations and regions. The booklet analyzed the definitions of SMEs according to various sources at the following levels:

(a) International – European Commission, Multilateral Investment Guarantee Agency (MIGA)/ International Finance Corporation (IFC) and United Nations Industrial Development Organization (UNIDO);

(b) Regional – based on World Bank data from 118 countries, collected from various local and international organizations, with a specific focus on Jordan's neighbouring nations in order to garner a regional view; and

(c) Local – industrial establishments' definition, BASEL II Agreement, Accredited Entrepreneur Initiative (AE), Business Development Centre, Jordan Enterprise Development Corporation and local commercial banks.

These definitions were then tabulated according to the prevalence of different indicators. The number of employees was by far the most commonly used indicator at all levels. For USAID (2007), the employment threshold is now a mandatory indicator for an enterprise to be defined as an SME, followed by a specific annual sales threshold and a total assets threshold.

Table II.2 summarizes the definitions of SMEs among selected Asia-Pacific and other economies. The number of employees as well as the size of investment is mainly used for such national definitions, while some countries also set separate definitions among different SME segments, such as manufacturing and services. Developing countries in Asia and the Pacific typically define SMEs, including microenterprises, as commercial entities less than 300 employees. Researchers that aim to compare the status of the SME sector across various countries mainly use the number of employees to define SMEs to avoid cumbersome calculations of foreign exchange rates among different currencies (AAMO, 2007).

The definition in each national context facilitates policy interventions, such as the provision of technical assistance, fiscal and financial concessions and other incentives, that target a specific group of enterprises. It also makes the physical identification of SMEs on the micro level possible, encouraging better articulation of the problems and prospects of the sector. It indicates that the more precise the definition is, the more effective will be the crafting of SME policies.[13]

[11] Emphasis is placed among local banks on using the "Total Credit Facilities" as an indicator of the size of the enterprise. However, this is not necessarily relevant to size, as a small amount of credit does not necessarily correlate to the size of the enterprise. Furthermore, a medium-sized enterprise could borrow a large amount of funds (USAID, 2007).

[12] For example, managerial experience, specialization level, education of staff, quality of relationship with buyers, form of production etc. (USAID, 2007).

[13] This is a generalization, since definitions of SMEs that are too nuanced will create many small categories and increase the total transaction costs of reaching all of them, thus undermining effective policy.

Table II.2. Definitions of SMEs in Asia and the Pacific and other areas

Country/area	Category of enterprises	Criteria and country's official definition	Measure
Asia and the Pacific			
Australia	Manufacturing	Manufacturing enterprises with fewer than 100 employees	Employment
	Medium	<100 employees	
	Small	<20 employees	
	Services	Non-manufacturing enterprises with fewer than 50 employees	
Brunei Darussalam	SME	<100 employees	Employment

Table II.2. *(continued)*

Country/area	Category of enterprises	Criteria and country's official definition	Measure
China	Manufacturing		Employment and turnover
	Micro	<20 employees and <yuan 3 million	
	Small	20-299 employees and yuan 3-19.99 million	
	Medium	300-1,000 employees and yuan 20-40 million	
	Wholesale		
	Micro	<5 employees and <yuan 10 million	
	Small	5-19 employees and yuan 10-49.9 million	
	Medium	20-200 employees and yuan 50-400 million	
	Retail		
	Micro	<10 and <yuan 4.99 million	
	Small	10-49 employees and yuan 1-4.99 million	
	Medium	50-300 employees and yuan 5-200 million	
Hong Kong, China	SME	<100 employees	Employment
India	Manufacturing		Manufacturing enterprises are defined in terms of investment in plant and machinery
	Micro	≤Rs 2.5 million	
	Small	≤Rs 50 million	
	Medium	≤Rs 100 million	
	Services		Service enterprises are defined in terms of investment in equipment
	Micro	≤Rs 1 million	
	Small	≤Rs 20 million	
	Medium	≤Rs 50 million	
Indonesia	SME	<100 employees	Employment
Japan	Manufacturing	<300 employees or asset capitalization <¥ 100 million	Employment and asset
	Wholesaling	<50 employees or asset capitalization <¥ 30 million	
	Retailing and services	<50 employees or asset capitalization <¥ 10 million yen	
Malaysia	Manufacturing (including agro-based industries and manufacturing related services)		Employment or annual sales turnover
	Micro	<5 employees or <RM 250,000	
	Small	5-50 employees or RM 250,000-RM 10 million	
	Medium	51-150 employees or RM 10-25 million	
	Services (including ICT) and primary agriculture		
	Micro	<5 employees or <RM 200,000	
	Small	5-19 employees or RM 20,000-RM 10 million	
	Medium	20-50 employees or RM 1-RM 5 million	
Republic of Korea	Manufacturing	<300 employees	Employment
	Services	<200 employees	
Singapore	SME	<$S 100 million annual sales turnover <200 employees	Employment or turnover
Taiwan Province of China	Manufacturing, mining, and construction	Invested capital ≤NT$ 80 million or employees <200	Employment, invested capital, or turnover
	Others	Sales revenue ≤NT$ 120 million or employment <50	
	Micro	Employment <5	
Thailand	Manufacturing and services		Employment and capital
	Small	≤50 employees or capital ≤B 50 million	
	Medium	51-200 employees or capital over B 50 and ≤B 200 million	
	Wholesale		
	Small	≤25 employees or capital ≤B 50 million	
	Medium	26-50 employees or capital over B 50 and ≤B 100 million baht	
	Retail		
	Small	≤15 employees or capital ≤B 30 million	
	Medium	16-30 employees or capital over B 30 and ≤B 60 million	

Table II.2. *(continued)*

Country/area	Category of enterprises	Criteria and country's official definition	Measure
Viet Nam	SME	≤300 employees; capital ≤D 10 billion	Employment and capital
Other states, regions and multilateral agencies			
Asian Development Bank	SME	No definition	None
European Union	Micro Small Medium	<10 employees; turnover ≤€ 2 million or balance sheet total ≤€ 2 million <50 employees; turnover ≤€ 10 million or balance sheet total ≤€ 10 million <250 employees; turnover ≤€ 50 million or balance sheet total ≤€ 43 million	Employment and turnover or balance sheet total
United Nations Development Programme (UNDP)	SME	≤200 employees	Employment
United States of America	Micro Small Medium	<20 employees 20-99 employees 100-499 employees	Employment
World Bank	SME	≤300 employees; turnover ≤$ 15 million; assets ≤$ 15 million	Employment, turnover, and asset

Sources: Agency for SME Development, 2011; *China Briefing,* 2011; European Union, 2003; Gibson and van der Vaart, 2008; M&SSE, 2011; Office of SME Promotion. 2011; Small Industries Development Bank of India, 2010; Small and Medium Enterprise Administration, 2011; and the Standards, Productivity and Innovation Board of Singapore (SPRING), 2011a.

C. Typology of SMEs

As reviewed in the above section, the most common typology of SMEs is based on their line of business, such as mining, manufacturing and services as well as wholesale and retail businesses. The SME definitions of some economies reflect this, such as India, Japan, Malaysia and Taiwan Province of China (table II.1). Table II.3 and figure II.1 present snapshots of SMEs in various sectors in Japan and Thailand, in terms of start-up composition, numbers and net incomes. It is noteworthy that SMEs in the service sector, such as retailers, restaurants and health care, are dominant in both countries. Manufacturing-focused SMEs also play a major role in Thailand and show a higher profit margin in Japan than the service sector.

Table II.3. Start-ups by sector in Japan and SMEs by sector in Thailand

(Unit: Per cent)

Sector	Start-ups by sector Japan (2009)	SMEs by sector Thailand (2010)
Services	29.3	8.3
Wholesale and retailing	16.5	49.7
Restaurants and hotels	13.9	9.3
Medical services and health care	14.8	0.3
Construction	9.5	3.5
Manufacturing	6.2	17.9
Transport and storage	3.6	3.9
Education	1.3	0.1
Others	5.1	7.1
Total	100.0	100.0

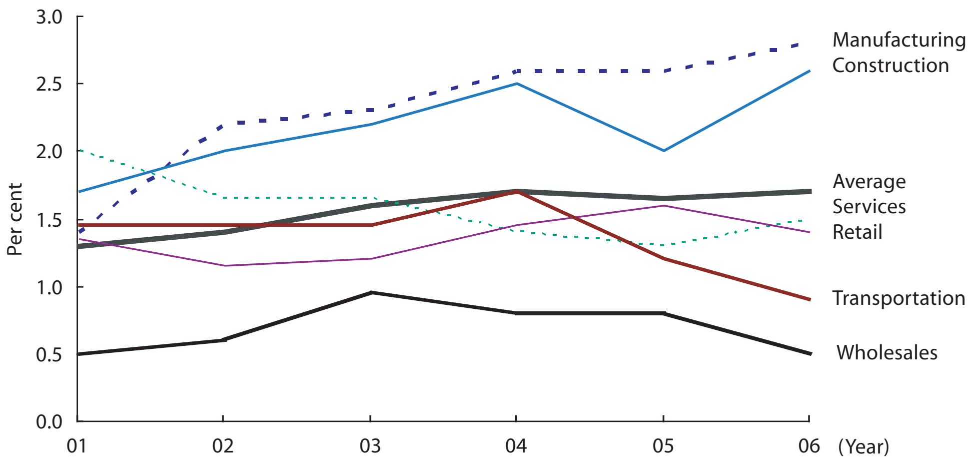
Sources: Japan Finance Corporation, 2009; and Office of SME Promotion, 2011.

In almost all of the countries in Asia and the Pacific, two distinguishing types of enterprises exist in the SME sector, i.e., registered enterprises and unregistered enterprises. According to IFC (2010), lower levels of economic development correlate with higher levels of informality.[14] Figure II.2 illustrates the shifts in SME and informal sector contributions to GDP as income levels change. A gradual increase in SME contributions and decrease in informality is seen as the income level increases. Therefore, it can be deduced that higher levels of formality relate to greater efficiency and higher rates of economic growth (IFC, 2010).

The unregistered enterprises in the informal sector dominate in most of the less developed economies in Asia and the Pacific. A study by AAMO (2007) found that in Asia and the Pacific, proprietary ownerships or closely-held partnerships comprised approximately 75 per cent of enterprises, while 22 per cent were private limited enterprises and only

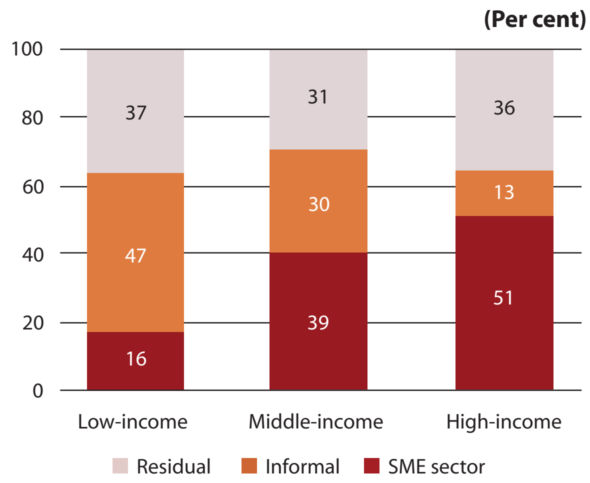
[14] The informal sector is a particular part of an economy that is typically characterized by small-scale and labour-intensive operations that offer poor working conditions and low wages. Demographic data for the informal sector, such as employers and type of employment, are particularly difficult to acquire in this region, as businesses in the informal sector are not usually registered in any form for legal purposes. As a rare exception, the ILO database shows that 72.1 per cent of the Thai workforce and 55.7 per cent of the Indian workforce were in the informal sector in 2002 and 2000, respectively, indicating the informal sector's significant role in some Asia-Pacific countries (ILO, 2009). There is a need for public incentives to make businesses formal to reduce the informal sector. Such incentives may include enhanced access to finance, grants, training, networking and information through formalization.

Figure II.1. SMEs' net income in Japan



Source: National Life Finance Corporation (2007).

Figure II.2. GDP contribution of the SME and informal sector, based on income levels*



Source: Ayyagari, Beck and Demirgüç-Kunt, 2003.
Note: "Residual" includes large enterprises and public sector.

3 per cent were limited enterprises.[15] Generally, rigid mindsets, lukewarm approaches to change and fear are among the main factors contributing to the continuance of proprietary patterns of ownership, thus hindering the process of their graduation to the formal sector. There has been a perceptible change in this pattern in recent years, as informal enterprises now prefer to be formalized as corporate entities in order to access additional financial sources. This trend of ownership from a proprietorship/partnership to a corporation has been observed in many countries of the Asia-Pacific region (AAMO, 2007).

The activeness of an enterprise or entrepreneur also varies among SMEs; these differences are important as they require different support. According to the Japan Small Business Research Institute (JSBRI) (2011), "passive" entrepreneurs start businesses for negative reasons such as just to make a living whereas "active" entrepreneurs start a business to achieve some personal goals, such as to own an enterprise, increase their income, have flexible working hours or contribute to society. In Japan, survey data indicate that 80 per cent of entrepreneurs can be classified as active and only 20 per cent as passive (JSBRI, 2011). Policy interventions would be different where entrepreneurs feel compelled to establish SMEs.

Enterprises can also be divided into the categories of "lifestyle" and "growth-oriented", each of which has differing demands (ADB, 2006). For example, when it comes to investment, investors will generally exit growth-oriented businesses through third-party purchase of shares, sale of entire company or listing on stock exchanges. In contrast, lifestyle businesses remain as proprietorships or are usually exited through repurchases of shares by the SME or owner/managers. Lifestyle businesses generally try to minimize retained earnings and suppress the value of their equity whereas growth-oriented businesses will aim to increase their share value (ADB, 2006).[16]

Another typology involves the life of an SME. Firms go through stages much like biological organisms – start-up, growth, maturity and exit (Chandler, 1961; and Scott, 1971). At each stage, an SME requires different inputs or different types of the same input. For example, an SME may only need a small loan at inception but may require equity for financing its growth. At the same time, newly-born SMEs usually experience the most vulnerable time at start-up, mainly due to the lack of a business plan and effective marketing that result in weak customer demand, before entering into the growth stages. Policymakers need to understand these nuances if they expect to serve the SME sector well. Making seed capital available for start-ups is a different policy focus

[15] An enterprise is a legally-recognized organizational entity that provides goods and services to consumers, and the way it is formed – proprietary owned, private limited or limited – are just different ways that a company chooses to distribute its stocks/shares. Proprietary-owned enterprises are owned and operated by a single individual with no distinction between the owner and the business. Private limited enterprises have at least one shareholder with a limited number of shares, but are usually owned and operated by a number of individuals who share the financial responsibilities; additionally, shares are not offered to the public. Limited enterprises are essentially the same as a private limited enterprise, with the only difference being that the shares may be offered to the public.

[16] Discussions here are very much in line with the concepts of entrepreneurship. For example, GEM uses the designations of "necessity" versus "opportunity" entrepreneurship. Growth orientation is also a key characteristic of entrepreneurship. See further discussion in chapter IV.

from developing equity capital markets; training for business plan development is also different from MBA training for TNC managers. Figure II.3 presents a simplified SME life cycle that explains an SME's growth, maturity and decline over time.

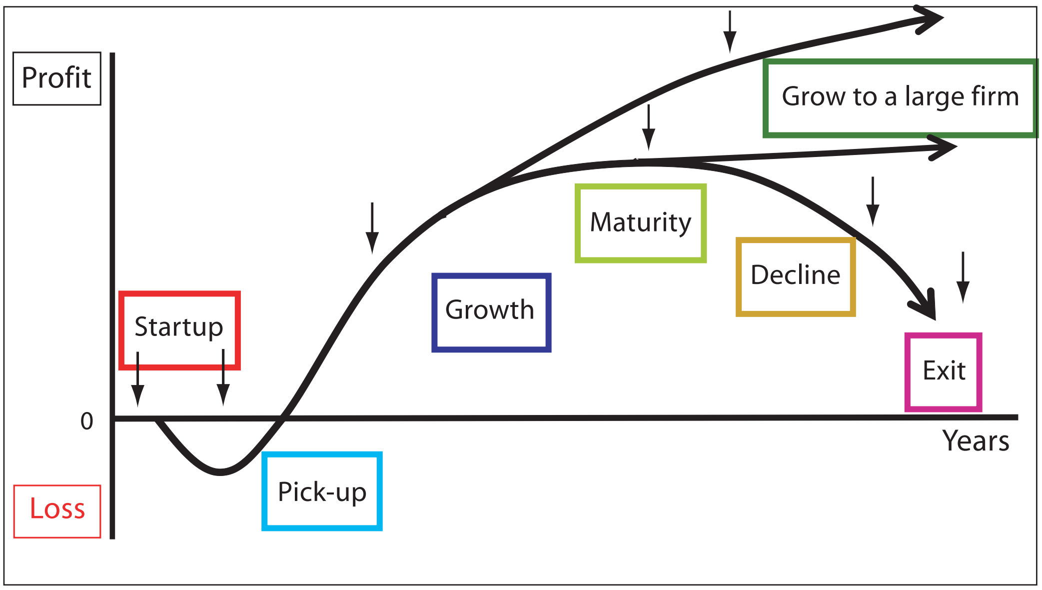
When government officials craft policies, they should remember that SMEs are heterogeneous and therefore have different needs, depending on their stage in the corporate life cycle, the degree of economic development of the country in which they are based etc. While it is impossible to customize policies for each individual SME, policies should be flexible enough to accommodate broad categories of needs. In addition, SME policies require constant updating as market conditions and the country's economy change.

Table II.4 assists in the effort to consider relevant policies for SMEs. It offers various categories influencing SME foundation, survival and growth. It may be useful for policymakers to organize SMEs in other ways, but these categories are the most relevant. The table specifically explains the category-based system where several indicators of business could be considered for SME development policies. This system might be used to assist policymaking for taxation and market orientationa and access (cf., IFC, 2007).[17] Each SME unit should fall in a particular grid based on the categories explained below, which in turn provides policymakers guidance and flexibility while drafting policies. For example, the profitability of an SME can be influenced by policies. Appropriate measures from policymakers may help the company, which is innovative but is domestic market-oriented, to enter into foreign markets.

The income divisions are the World Bank classifications using 2010 per-capita GNI according to the Atlas method (World Bank, undated). Middle income can be divided further into lower-middle income ($ 1,006 to $ 3,975) and upper-middle income ($ 3,976 to $ 12,275). Low income nations typically have a preponderance of the labour force in agriculture and light manufacturing, whereas middle-income nations are in various stages of industrialization. High income economies have a well-developed service sector and knowledge-intensive, high value-added industries. Given these differences, policymakers have to apply local knowledge;

[17] Table AIII.2 in annex III.2 presents the list of categories for SME taxation.

Figure II.3. Simplified SME life cycle



Source: Authors' compilation.
Note: The arrows indicate that different types of support are needed at the different life stages.

Table II.4. Categories for SME typology

Topic	Category 1	Category 2	Category 3 (if applicable)
Stage of economic development[18]	Low income, $ 1,005 or less	Middle income, $ 1,006 to $ 12,275	High income, $ 12,276 or more
Market orientation	Domestic	Gradual global	Born global
Pace of innovation	Incremental	Radical	
Use of technology	Isolated	Connected	
Corporate life stage	Nascent (<2 years)	Young (2-5 years)	Mature (5+ years)

Source: Authors' compilation.

[18] Follows the World Bank (undated) country classification based on income per capita.

what may be useful for the Lao People's Democratic Republic may not be for Japan, and vice versa.

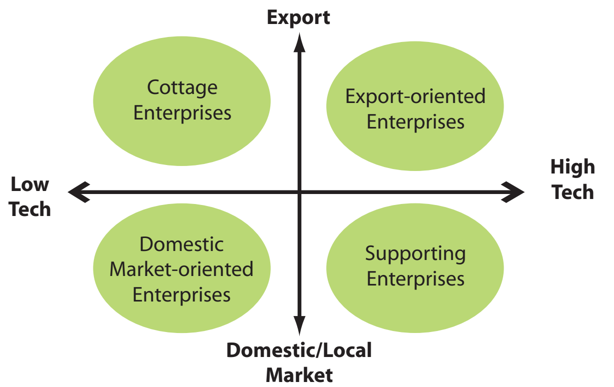
Market orientation is another facet of SME typology. Market orientation refers to a firm's assessment of who its customers are and how to meet their needs (Kohl and Jaworski, 1990; and Amario, Ruiz and Amario, 2008). Most SMEs are domestic; they exist only to satisfy their home market. This designation could encompass SMEs focusing on local, provincial or national markets. The "gradual global" SME accesses foreign markets, but typically will only export; however, some may also invest over time as they grow and accumulate knowledge of the foreign market (Johansen and Vahlne, 1977). The "born-global" firm sees the world as its market from inception; it does not internationalize operations incrementally (Oviatt and McDougall, 1994). These SMEs are generally in the high-tech sector and have owners with at least a university education. They use the Internet to satisfy global demand for their product or service. Policymakers should consider the fact that the first type will need the most basic kind of assistance to exploit local markets while the second and third categories require more specialized knowledge, such as navigating customs regulations.

The pace of innovation may also differ among SMEs. Innovations can be considered along a continuum from incremental to radical (Utterback and Abernathy, 1975; and Tushman and Anderson, 1986). The incremental type tend not to disturb markets and involve some minor form of product or service differentiation, e.g., opening a new restaurant. The radical type have disequilibrating effects on markets and perhaps on society (Schumpeter, 1934), e.g., development of the MacIntosh personal computer by Steve Jobs. By their nature, radical innovations tend to be rare and incremental innovations more common. Policies to encourage and support radical innovations are most important, since the SMEs driving them will create more wealth and jobs for the economy. However, policymakers must also serve the great mass of SMEs that only engage in incremental innovation.

Another concept is use of technology (particularly ICT) (see box II.1) such as mobile devices and the Internet. Most SMEs tend to be isolated in the developing countries of the region; they often have limited access to the web and they transact business directly, both with customers and with suppliers. On the other hand, a minority of sophisticated SMEs can handle their affairs remotely and electronically, e.g., receiving orders from customers and placing orders with suppliers on the Internet, managing their finances with wireless banking etc. It encourages policymakers to persuade more SMEs to become connected, as this is essential in a fiercely competitive global economy.

One would expect to find more SMEs engaged in radical innovation in the high-income countries, and that these SMEs are connected and serving global markets.[19] Figure II.4 is a guide to thinking about heterogeneity among SMEs. Policymakers must always apply local knowledge to these rubrics.

Figure II.4. SME typology by market and technology



Source: Uchikawa and Keola, 2009.

[19] For example, wages and labour productivity of small enterprises in the Republic of Korea are, on average, at least three times higher than those of large enterprises in many other developing Asia-Pacific economies (ADB, 2009).

Box II.1. SME typology by market orientation and use of technology

The typology of SMEs can also be described in terms of both their market orientation (domestic or export; see chapter VIII for a more detailed discussion on this aspect) and the use of technologies they use (also see chapter VII). Based on two criteria, SMEs could be categorized into four groups: (a) supporting industry (see note 1); (b) export-oriented enterprises; (c) domestic market-oriented enterprises; and (d) cottage enterprises (see note 2).

Figure II.4 illustrates these four SME categories. In many developing countries in Asia and the Pacific, SMEs typically use low levels of technology and are categorized as domestic market-oriented SMEs and cottage enterprises that dominate the private sector. Some of the smaller enterprises, however, do play an important role in exporting in some economies and industries (ADB, 2009). For example, there is generally a large technological gap between domestic market-oriented SMEs and SMEs in the supporting industry that are required to supply parts and components with consistent quality and on schedule to industrial buyers. Domestic market-oriented SMEs often do not have adequate quality control and production capability to meet industrial buyers' stringent requirements.

Although it is not easy for domestic market-oriented SMEs to graduate to the supporting industry group, due to required levels of technology and management skills, some have accomplished such a shift. SME development policies could promote such transformations through capacity-building (Uchikawa and Keola, 2009).

Source: Modified from Uchikawa and Keola, 2009.

Notes:

1. Supporting industry is defined as a group of SMEs having domestic forward linkages with the manufacturing sector, including small and medium-sized transport and storage firms and wholesalers.
2. Although a number of cottage enterprises are active in exporting, the majority of them are not export-oriented due to their low supply capacity.

Box II.2. Start-up profiles in Japan

The National Life Finance Corporation of Japan (2008) conducted a survey of 918 enterprises to which it had provided loans between April and September 2006; all the enterprises were in their first or second year of operation. The following results were obtained:

Entrepreneurs:

(a) Average age was 41.4 years old;
(b) A total of 84.5 per cent were men and 15.5 per cent were women; and
(c) A total of 33.1 per cent held a college degree or higher.

Enterprises:

(a) An average of 3.9 employees;
(b) Start-up funds, $ 100,000
    (i) Own capital – 35 per cent;
    (ii) Support from family, relatives and friends – 15 per cent; and
    (iii) Public grants and commercial loans, with collateral and/or partially covered by public loan guarantee schemes – 50 per cent.
(c) A total of 60 per cent of start-ups achieved break-even status within 15 months.

D. Common characteristics of SMEs

Unlike large enterprises, SMEs are more flexible and able to adapt to changing business environments. This agility is present in almost every facet of their business operations. In general, SMEs are able to avoid the rigidity and inertia common to established firms in their planning and strategy. They are an important source of innovation, both in products and in processes.[20] If they are not actively innovating, SMEs are more willing to adopt the best practices of others because their own routines are malleable. Their smaller size enables the management of human resources to be more informal than in larger companies. This allows flexibility in matching personnel to the myriad problems that SMEs face. Despite regional and country variations, SMEs have a range of common characteristics (AAMO, 2007; JSBRI, 2011; and Shane, 2008):

(a) Born out of individual initiatives, knowledge and skills – SME start-ups tend to evolve from a single entrepreneur or a small group of entrepreneurs – in many cases, leveraging a unique skill set;
(b) Greater operational flexibility – the direct involvement of owner(s), coupled with flat organizational structures, ensure that there is greater operational flexibility. As a result, decision-making is faster;
(c) Low cost of production – SMEs have lower overheads. This translates into lower production costs;
(d) Specialization in niche markets – successful SMEs concentrate on small but profitable markets in order to avoid battles with large enterprises as well as to ensure effective investment and utilization of their resources and expertise;
(e) A high propensity to adopt technology – SMEs show a propensity for adopting and internalizing new technology when given the proper incentives and learning;
(f) A high capacity to innovate – SMEs' capacity for innovation, improvisation and reverse engineering is extensive if the initial support is there;
(g) High employment orientation – SMEs are usually the prime drivers of job creation, in some cases creating up to 80-90 per cent of the total jobs in a country. SMEs tend to be labour-intensive and are able to generate more jobs for every unit of investment, compared with their larger counterparts;
(h) Utilization of locally available human and material resources – SMEs mostly utilize skills, manpower and resources available locally. This brings prosperity to the area where they operate; and
(i) Reduction of geographical imbalances – unlike large enterprises, SMEs can grow in developed and underdeveloped areas. This reduces geographical imbalances.

However, these characteristics of SMEs also have a downside. SMEs' small operational size and lack of resources (e.g., capital and human), skill/knowledge and network connections are a common feature. SMEs typically suffer from:

(a) Low bargaining power, both for sales and for procurement (i.e., low prices and high costs, leading to low income and less profit);
(b) Weak market access;
(c) Low technology adaptation;
(d) Lack of brand development;
(e) High debt structure;
(f) Weak management with less training;
(g) Weak human resource base with a low level of compensation; and
(h) Inadequate institutional support.

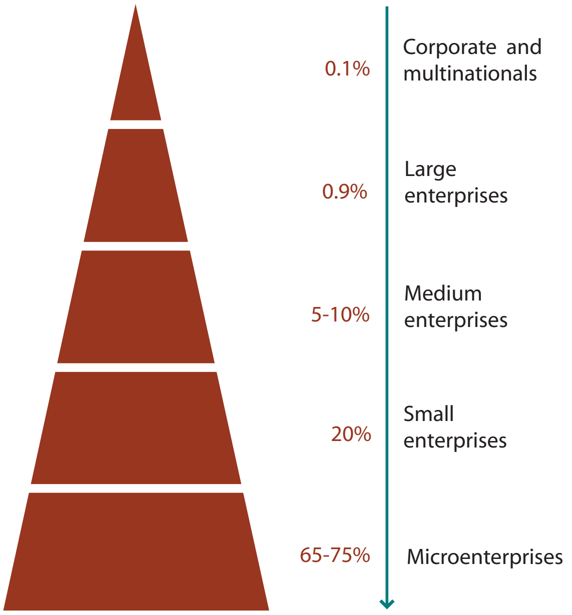
E. Contribution by SMEs

SMEs constitute an important segment of Asia-Pacific economies, and have made a laudable contribution to the economic development of various countries over the years. The role of SMEs is mainly to: (a) create employment; (b) nurture entrepreneurship, including that of women and youth; and (c) increase outputs with value-added. Thus, the development of SMEs contributes to increased GDP and poverty alleviation (ESCAP, 2009b).

In developing as well as developed economies, including those in the Asia-Pacific region, it is clear that SMEs dominate the classification for enterprises, in most cases constituting more than 99 per cent of all enterprises. Figure II.5 illustrates the constitution of the business environment in an emerging

[20] Innovation as a competitive advantage for SMEs naturally bolsters the national competitive advantage. For policymakers, the two greatest benefits of SME development for a country as a whole are innovation and job creation. Schumpeter (1942) viewed entrepreneurs as the catalyst for his famous "perennial gale of creative destruction" that would doom stodgy businesses but lead to technological and material advancement for society.

Figure II.5. Constitution of enterprises by size



Source: IFC, 2009.
Note: Percentages represent the number of companies.

economy. The majority of firms are microenterprises and the next biggest sector is the SMEs. It is noteworthy that large enterprises and corporate multinationals typically only constitute a very minor percentage of the business environment.

SMEs generally employ 60 per cent or more of the enterprise workforce (table II.5) and account for a significant share of job creation. Small enterprises and non-manufacturing enterprises exhibit higher net job creation rates compared with large enterprises (ADB, 2009).[21]

Exporting is one of the major contributions made by SMEs to the national economy (as well as value-added). This consists of not only high export volumes but also diversified exports and technology and skill development, which are fostered through dealing directly with competitive, heterogeneous foreign markets. Export operations expand the base of domestic enterprises, which gain the ability to compete globally; thus, national competitiveness is enhanced alongside income generation. The share of SMEs'

[21] Large enterprises tend to move towards capital-intensive production facilities (e.g., assembly automation), with reduced dependency on labour but needing a skilled workforce.

Table II.5. Contribution of SMEs to exports/enterprises/workforce in selected economies of the world, and Asia and the Pacific, various years during 2001-2009

Region/country/area	Export share in GDP (1)	SME share in exports (2)	SME share of total enterprises (3)	SME share of total workforce (4)
Developed countries				
France	23.0	42.4	99.8	61.4
Germany	41.0	55.9	99.7	79.0
Japan	13.0	53.8*	99.7	70.2
Spain	23.0	68.5*	99.9	78.7
United Kingdom	28.0	45.9*	99.6	54.0
United States	11.0	22.2	99.9	55.8
European Union	n.a.	43.4	99.8	67.4
Asia and the Pacific				
China	27.0	69.2	99.0	74.5
India	20.0	40.0	n.a.	n.a.
Indonesia	24.0	20.0	99.9	99.6
Malaysia	96.0	19.0	99.2	59.0
Pakistan	13.0	30.0	97.9	78.5
Republic of Korea	50.0	39.0	99.9	87.7
Russian Federation	28.0	54.0**	97.6	60.9
Singapore	221.0	16.0	91.5	51.8
Taiwan Province of China	n.a.	17.0	97.8	77.2
Thailand	57.5	30.6	99.6	69.0
Viet Nam	68.0	20.0	99.9	77.3
Micronesia (Federated States of)	n.a.	n.a.	>90.0	20.0

Sources: World Bank, 2011a. Columns (2)-(4): ADB, 2001; Bank of Negara, 2005; European Commission, 2005 and 2009a; General Statistics Office of Viet Nam, 2011; Korean National Statistical Office, 2009; National SME Development Council of Malaysia, 2010; Organisation for Economic Co-operation and Development (OECD), 2005a and 2011; Office of SME Promotion of Thailand, 2011; Small and Medium Enterprise Administration, 2010; Tambunan, 2006 and 2009; USAID, 2004; and United States International Trade Commission, 2010.
* Value-added.
** Share of total sales revenue.

contribution to exports varies widely among countries in the Asia-Pacific region, ranging from 19.0 per cent in Malaysia to 69.2 per cent in China (table II.5). The varying ability of SMEs to export is an indication of how SMEs can or cannot compete in regional and global markets, where specific support measures may be needed to improve performance (UNCTAD, 2002).[22] SMEs' contribution to exports is generally higher in developed economies, such as those in the European Union, than in the developing economies of Asia and the Pacific.[23]

In summary, the contribution of SMEs is vital to the well-being of various countries in the region as they:

(a) Constitute over 99 per cent of all enterprises;

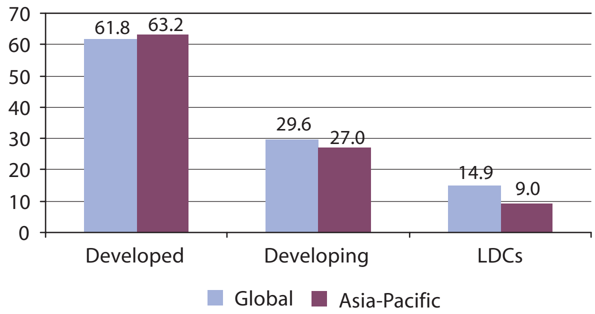
(b) Provide over 60 per cent of the private sector jobs; and

(c) Share more than 20-30 per cent of direct and indirect exports.

However, SMEs are still underdeveloped in many countries in Asia and the Pacific, although they have contributed to the economic development of the region. In particular, the SME sector remains relatively weak in Asia-Pacific developing countries, especially in least developed countries (LDCs) – even though the importance of SMEs in the national economy is well-recognized in terms of their substantial shares in the number of enterprises and their contribution to employment, income and exports.

Figure II.6 shows that developed countries possess a large number of SMEs, including microenterprises, with 63 enterprises per 1,000 people for developed countries in the Asia-Pacific region in 2001-2006. In contrast, the Asia-Pacific region's developing countries had only 27 enterprises and least developed countries only registered a paltry nine enterprises per 1,000 people. In addition, many enterprises in the region are in the informal sector, which governments neither tax nor monitor (ESCAP, 2009b). In countries with poor business environments, SMEs choose to remain informal due to the costs and procedural burden of joining the formal sector (World Business Council for Sustainable Development, 2007).

Figure II.6. Number of SMEs per 1,000 people, 2001-2006



Source: ESCAP, 2009b.

F. Start-up, growth, maturity and exit[24]

SME development pertains to four stages in the SME 'life cycle': start-up, growth, maturity and exit. Some SMEs may encounter just one or two of these stages (i.e., start-up and exit), while others may experience all four stages (see figure II.3).

[22] This point may need to be revisited based on the fact that definitions of what constitutes a SME vary quite widely from country to country in Asia and the Pacific, and even within single countries. An extreme example is China, which defines medium-sized enterprises as those with less than 1,000 employees, while in Malaysia medium-sized enterprises are those with 150 or less employees. Developing economies in Asia and the Pacific typically define SMEs, including microenterprises, as commercial entities with less than 300 employees.

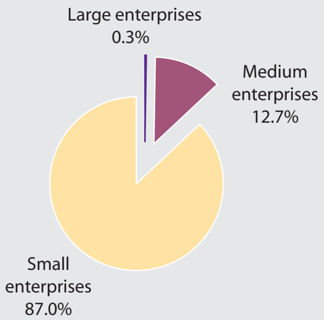
[23] For developed economies, exports are not relatively large components of GDP, while developing economies in Asia and the Pacific are reliant on exports as a significant source for GDP growth (e.g., Malaysia and Thailand) in line with their export-oriented developmental strategies. Generally speaking, a trend can be seen in that as nations rise to high-income status, their reliance on exports as a driving force of GDP growth is diminished – most likely the result of strong domestic demand growth. Additionally, SMEs appear to be the driving source of exports in developed countries, compared to developing countries (at least in the Asia-Pacific region).

[24] This section was extracted from ESCAP, 2009, unless otherwise stated.

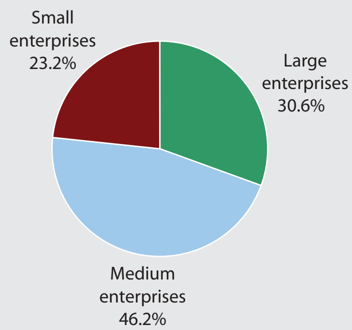
Box II.3. Contributions by SMEs in Japan

In Japan SMEs make up 99.7 per cent of enterprises, more than two-thirds of employment and close to 50 per cent of manufacturing value-added, as shown in the pie charts.

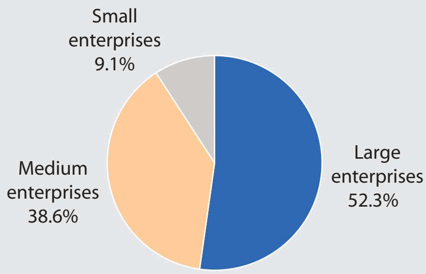
Number of enterprises (4,210,000 in 2006)



Number of employees (40,130,000 in 2006)



Manufacturing value added (101.3 trillion yens in 2008)



Source: JSBRI, 2011.

The first critical stage of an SME's development is that of "start-up", or market entry. This entails all the steps and procedures for starting a business, in compliance with the laws and regulations of the host country. There are typically two important factors in this regard: (a) the time it takes to start a business; and (b) the cost of doing so. If the time is too long or the costs are too high, this will serve as a major barrier for many potential new businesses as well as a potentially major loss for the economy, in terms of jobs foregone, income not generated etc. These are certainly not the only potential inhibitors to SME start-up rates. For example, if an entrepreneur is unable to gain access to the capital needed to finance the planned business venture, he/she may opt not to proceed. Some observers have argued that the start-up phase for an SME usually lasts around 3.5 years (or 42 months). If an SME passes that landmark date, then it has graduated beyond the critical period when most young companies tend to fail, and therefore can be regarded as a potentially sustainable business.

Once an SME has successfully entered the market and commenced operations, a number of other factors will be critical to its subsequent performance. These factors first determine whether it can sustain its business model beyond the short term, and then dictate whether it will grow to prosper as a competitive entity or simply be a survivor reaching the mature stage. This entails interplay between the SME itself and its wider enabling environment. In Japan, for example, key inputs include (but are not limited to) access to: (a) quality human capital; (b) a range of appropriate financial resources; (c) an adequate customer base; (d) accurate and timely market information and an ability to analyse that information in a meaningful way; (e) knowledge and technology; and (f) capable suppliers (JSBRI, 2011). The more conducive the enabling environment, the more likely an SME will thrive and not just survive.

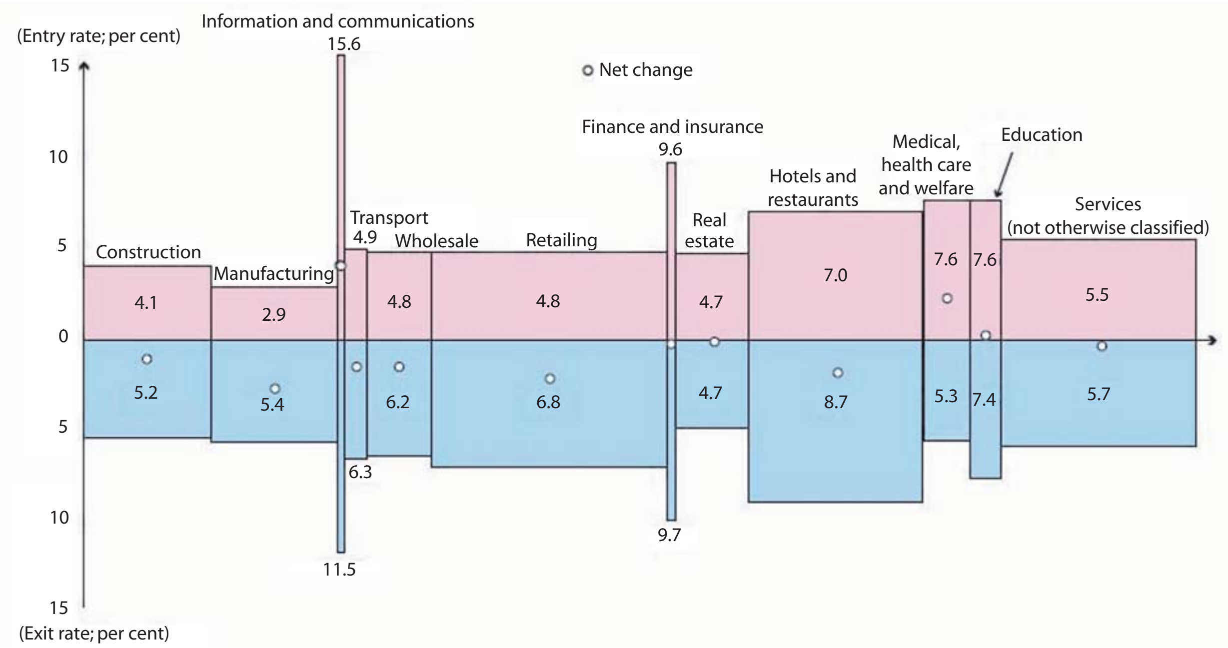
Turning now to exits by SMEs, two scenarios need to be considered. The first is that an SME develops into a large enterprise, and therefore graduates beyond the SME sector. For all concerned, this is perhaps the most welcomed outcome for an SME. Needless to say, not every SME goes through this growth path, as the failure rate of new businesses is considerably high. The second is the demise and closure of an SME, for whatever reason.[25] This is an unfortunate outcome, but it should not be dismissed as a policy irrelevance. It is inevitable that not all SMEs will be successful. Some will have an early demise, while others may close after considerable time. In general, at least one-third of all new companies around the world close within two years of commencing operations.[26] In Canada, for example, two-thirds of new businesses discontinue within five years (Ibrahim and Soufani, 2002). In New Zealand, enterprises' four-year survival rates are 50 per cent and 40 per cent in manufacturing and services sectors, respectively (OECD, 2011). The survival rate for small businesses, such as restaurants and retailers, is even lower at around 20 to 30 per cent in the first year, and only about half of those who survive the first year will remain in business during the following five years (Holland, 1998). New businesses face a particularly difficult time during their start-up period. According to the Japan Finance Corporation (JFC) (2009), in Japan, approximately 44 per cent of new companies are still losing money after being open for one year.

Considerable differences in entry and exit rates are also observed across industrial sectors. In the United Kingdom for example, while approximately one-third of enterprises close within three years, such sectors as hotels and restaurants, mining and utilities, transport and communications and wholesale and retailing experience higher exit rates than other sectors (Department for Business Innovation and Skills, United Kingdom, 2007). Figure II.7 highlights sectoral differences in Japan, which has experienced a large number

[25] As Headd (2003) noted, not all SME closures stem from business failure; some are the consequence of an orderly exit by the owner(s).

[26] Authors' calculation, based on the data of 17 OECD member and non-member countries obtained from the OECD Structural and Demographic Business Statistics Business Demography Indicators at http://stats.oecd.org/Index.aspx?DataSetCode=SDBS_BDI.

Figure II.7. Entry and exit rates, by industry, in Japan, 2004-2006



Source: JSBRI, 2011.
Note: The horizontal axis indicates the proportion of all enterprises in the beginning of 2004.

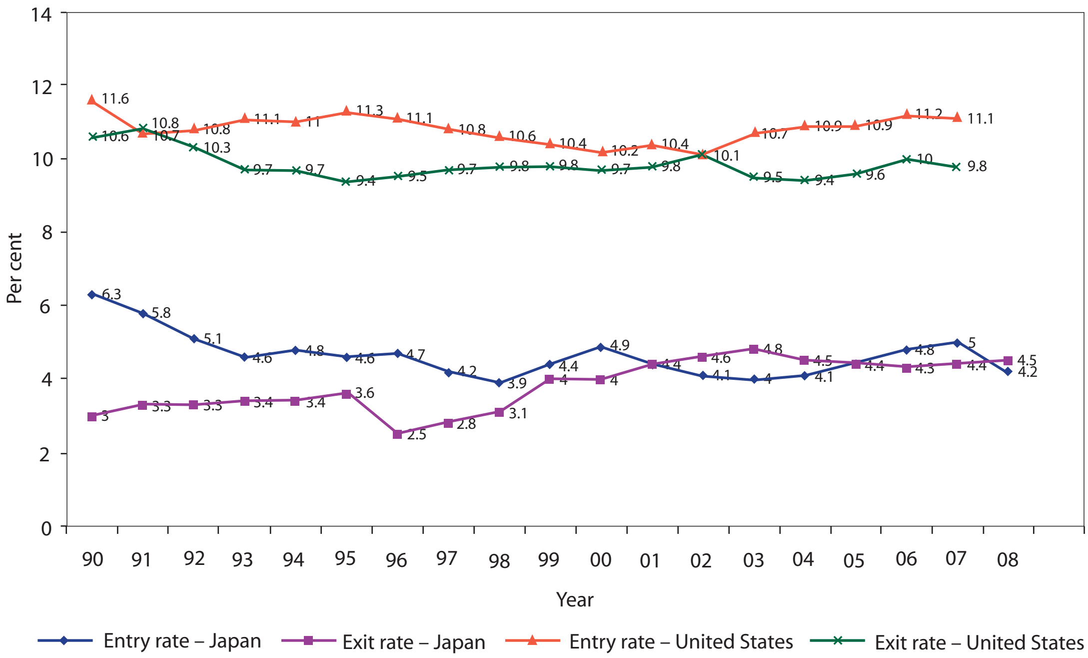
of entries in the information and communication sector as well as the medical, health care and wealth sector, exceeding their exit rates. The finance and insurance, hospitality and education sectors have attained both high entry rates and high exit rates (JSBRI, 2011).

Figure II.8 highlight the differences in entry and exit rates as well as survival rates of new businesses in Japan and the United States. A growing economy experiences more entries than exits, which is a useful indicator for policymaking and adjustment.[27] Entry and exit rates of the United States are both twice as much as those of Japan, strongly supporting a commonly shared belief about the dynamism of the American economy. As a result of these high entry and exit rates, one quarter of start-ups close within the first year of business and more than 70 per cent of start-ups close within 10 years in the United States (Shane, 2008). In contrast, less than 10 per cent of new businesses close within two years in Japan while approximately 70 per cent of new enterprises are still in business after 10 years.

The large differences between Japan and the United States in entry and exit of enterprises as well as enterprise survival could be, at least partially, explained by their different national cultures and attitudes toward entrepreneurship. Figure II.9 indicates that the Japanese appreciate steadiness and stability more than Americans. Compared with Americans, fewer Japanese consider themselves to have the opportunities, abilities or desire to pursue an entrepreneurial career, as they fear the consequences of failure. Cultural and attitudinal aspects can negatively (or positively) affect national entrepreneurship activities.

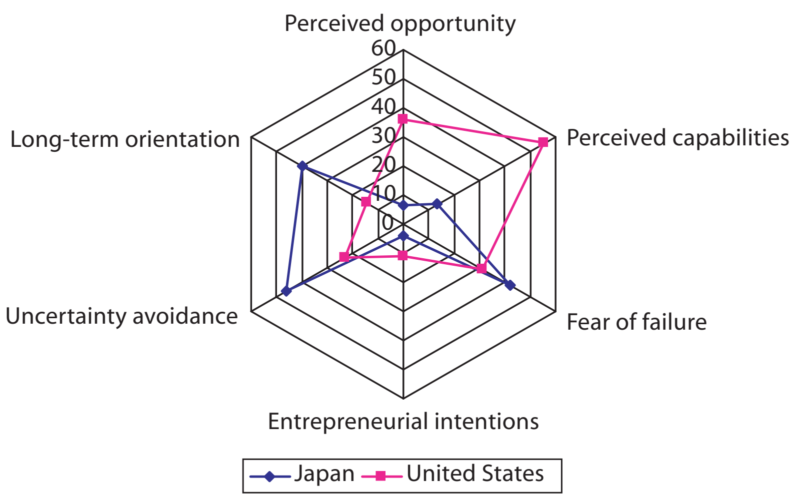
[27] In Thailand, the Office of SME Promotion (2010a) statistics show that while 63,000 enterprises were closed down in 2009, only 41,000 enterprises were newly founded, implying the adverse impact of the global economic crisis as well as the informal sector's considerable role within the country.

Figure II.8. Comparison of entry and exit rates between Japan and the United States, 1990-2009



Source: Authors' compilation, based on data from JSBRI, 2011.

Figure II.9. National culture and entrepreneurship, Japan and the United States



Sources: GEM, 2011 and Hofstede, 1991.

Policymakers naturally want firms to stay in business and provide jobs; however, not all businesses can be saved. Most attention is typically paid by policymakers to the first stage – start-up or market entry – while relatively less effort is expended on the latter stages – exit or closure – for understandable reasons (Dannreuther, 2007). As a result, while countries are often quite zealous in recording and reporting company start-ups, they tend to be much less focused on recording company closures, particularly in Asia-Pacific developing countries.[28] There is little utility in allocating resources to prolong the life of a terminally-ill SME. It is better to allow failing SMEs to exit instead of trying to prop them up with scarce resources that can be used more efficiently elsewhere in the economy. Smooth bankruptcy procedures for troubled firms, allowing for exit with minimal cost, are an important feature of the SME development landscape. The important issue for policymakers is to ensure that their closure does not become a constraint on the emergence of new SMEs, and hopefully some of the lessons learnt are disseminated to the collective awareness of the local business community.

This asymmetry in the focus of most SME development can be misguided in some cases. For example, too much emphasis on removing market entry obstacles alone can, over time, result in diminishing returns for policymakers and development partners. Rather, there needs to be a balanced portfolio of interventions that can assist SMEs overcome obstacles throughout their development trajectory. Another inhibitor can also be found at the opposite end of the SME "life cycle" – exit or closure. If the regulations pertaining to shutting down a business or to bankruptcy are too onerous, then an entrepreneur may be unwilling to take the risk of establishing an SME. Given the risks that accompany every new business venture, this can be a serious factor in reducing start-up rates.

G. Microenterprises

Microenterprises are a subcategory of small enterprises and typically classified based on the number of employees, annual turnover and asset size.[29] A combined and comprehensive definition of a microenterprise is "a very small enterprise that is typically owner-operated and participated by marginalized segments, that sells a product or service through entrepreneurial methodologies and utilizing diverse organizational forms" (Munoz, 2010).

As can be seen from table II.6, the term microenterprise is perceived and utilized in different ways across countries and in some cases by sector. These differences may generate inaccuracy in the vertical comparison of microenterprises among these five countries (as well as others). However, some common points can be made, including: (a) microenterprises comprise the majority of all enterprises and are the main constituents of SMEs; and (b) apart from for Viet Nam and, to a lesser extent, Malaysia, the national percentage of microenterprises are comparable.

In more advanced industrial economies (Japan and the Republic of Korea), there are greater numbers of enterprises, with microenterprises comprising the majority, at 87.0 per cent and 87.9 per cent, respectively, than those seen in developing economies (except the Philippines). Specifically, Viet Nam and Malaysia both have lower numbers of microenterprises, i.e., 55.9 and 78.7 per cent, respectively. In addition, the variation seen within the three selected developing Asia-Pacific economies ranges from 55.9 per cent (Viet Nam) to 91.1 per cent (Philippines); this may be explained by the presence of the large informal sector and their weaker business environments.

Microenterprises share some common characteristics (Eversole, 2004; Larson and Shaw, 2001; Lee, 2008; and Tambunan, 2010):

(a) Usually owner-managed, with family members working in the enterprise;

(b) Many in the informal sector so no statistical record available;

(c) Often constrained by capital shortages;

(d) Lower market entry barriers;

(e) Largely situated in rural areas particularly as agriculture-related business;

(f) Feature high rates of start-ups and business termination; and

(g) Operated under flexible arrangements and locations according to market trends and customer requirements.

Due to the unique characteristics of microenterprises, the issues that have an impact on SME development also apply and, in some cases, are exacerbated. These constraints include:

(a) Gaps between rapidly-growing demands of microenterprises for capital, manpower and other resources, and government awareness and support;

(b) A lack of access to formal financial services, especially in rural areas where most of the microenterprises are located. This constraint is further aggravated by the low profit margins for banking institutions and the high-risk nature of microenterprises;

(c) A lack of access to business development services such as marketing, training in basic business skills, business incubation etc.; and

(d) Low bargaining power and vulnerability to economic shocks.

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28 OECD has developed a database of enterprise statistics called Structural Demographic Business Statistics for selected member and non-member countries, covering entry and exit rates of new enterprises together with their five-year survival rates (http://stats.oecd.org/Index.aspx?DataSetCode=SDBS_BDI).

29 According to the European Union's definition of a microenterprise, the annual balance sheet or turnover does not exceed € 2 million and the total number of employees is less than 10 people (European Commission, 2003).

Table II.6. Share of microenterprises in selected Asia-Pacific countries, 2010

Country	Microenterprise definition	Number of enterprises	Number of SMEs	Number of microenterprises	Share of SMEs, excluding microenterprises	Share of microenterprises
Japan	Manufacturing: 20 or fewer employees. Trade and services: Five or fewer employees.	4 210 070	4 197 719	3 663 069	12.7	87.0
Republic of Korea	Manufacturing, mining, construction and transportation: Less than 10 employees. Other sectors: Less than five employees.	2 976 646	2 974 185	2 616 222	12.0	87.9
Viet Nam	All sectors: One to nine employees.	205 689	203 331	114 928	43.0	55.9
Philippines	Asset size less than P 3 million, or between one and nine employees.	780 479	777 357	710 822	5.5	91.1
Malaysia	Manufacturing, manufacturing-related services, and agro-based industry: Sales turnover of less than RM 250,000, or less than five full-time employees. Services, primary agriculture, information and communications technology: Sales turnover of less than RM 200,000, or less than five employees.	552 849	548 267	434 939	20.5	78.7

Sources: Department of Statistics (Malaysia), 2011; Department of Trade and Industry of the Philippines, 2011; General Statistics Office of Viet Nam, 2011; Ministry of Economy, Trade and Industry of Japan, 2011a; and Small and Medium Business Administration of Japan, 2011.

H. SME productivity

Firm productivity measures the efficiency of how a firm transfers inputs into outputs. Therefore the productivity of a firm is a reflection of both labour ability and technology. The main determinants of productivity include access to materials, quality and size of workforce, the capabilities of management, the organizational structure, the use of technology and the level of capital sufficiency.

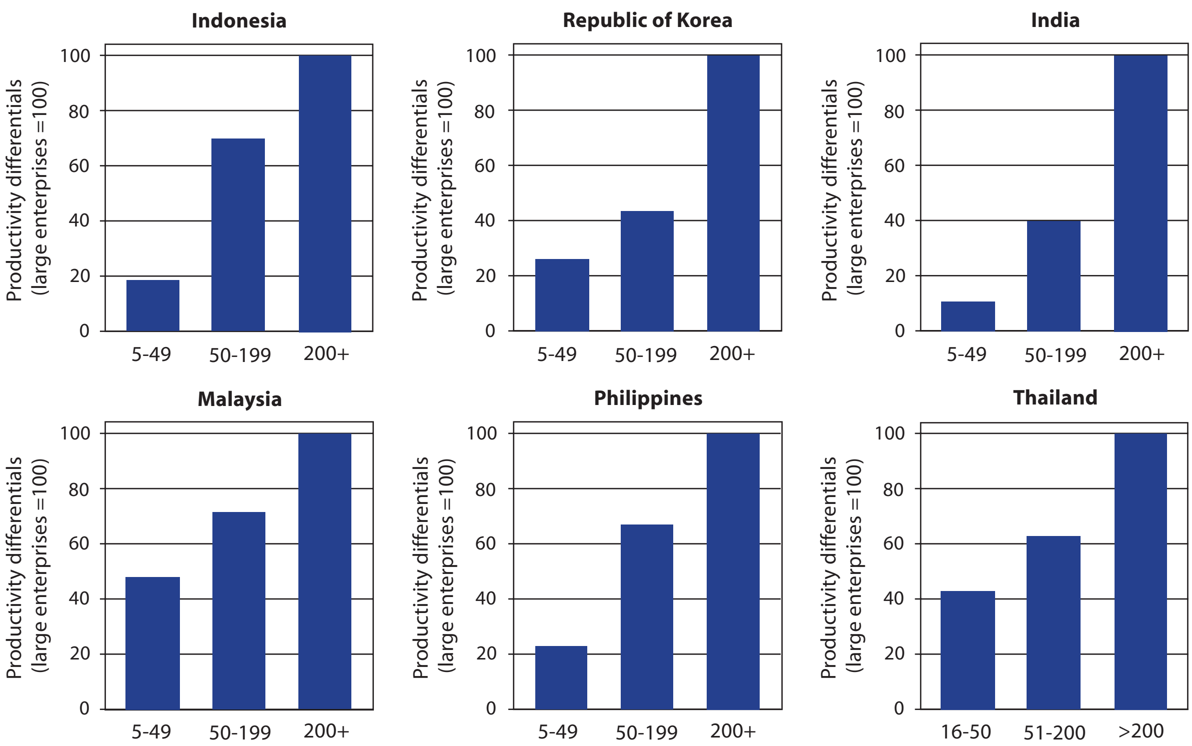
In general, it is more difficult for SMEs to achieve the same productivity levels as those of larger firms due to several constraints (figure II.10). Apart from scale restrictions, SMEs tend to face higher costs of capital and fewer capital resources. The lack of new technologies and managerial capacities also reduce their abilities to raise productivity. SMEs tend to pay lower wages than large firms, preventing them from acquiring and keeping highly-skilled labour. All these elements add barriers to achieving high productivity in SMEs. As a result, SMEs often suffer from higher rates of failures and exits, compared with large firms (Berry, 2007). Microenterprises often operate in the informal sector, exhibit even lower labour productivity and generate less earnings for their owners and employees than small enterprises (figure II.11). Recent research suggests that many micro-entrepreneurs may not be "capitalists in waiting" (de Mel and others, 2010). On the other hand, given the relative scarcity of capital in economies, large firms achieve lower total factor productivity (TFP)[30] than SMEs – possibly because large firms use their capital less efficiently (European Commission, 2005).

As mentioned above, SMEs face more constraints and risks than large firms but they also have the potential to improve the aggregate productivity of the economy. Small firms often act as a major engine of innovation with their flexibility; therefore, growing SMEs can heighten competition by disrupting the "cozy relationships" within an industry, and more SMEs can increase the level of competition and cause those performing badly to exit (Mole, 2002). In this context, policy support could be a key factor in stimulating this progress. Empirical studies imply that properly aimed SME policies might have a significant positive effect on aggregate productivity by reallocating capital resources towards SMEs (Ibarrarán and others, 2009). Here, the policies refer to those aimed at increasing firms' productivity through the promotion of training, innovation, quality certification and facilitation of SME financing.

For example, Japan has a moderate tax credit for R&D investment of 20 per cent; the rate for SMEs can be higher by as much as 6 per cent (APEC, 2006a). As SMEs tend to be more sensitive to tax credits than large firms, this policy enhances innovations at SMEs, which are identified as a main source of productivity gain. Another example involves the Business Incubation Centre of Zhongguancun Haidian Science Park in Beijing, which provides comprehensive services such as business incubation, finance, technical consultation, logistics and recruitment to tenant high-tech SMEs. The resources and services provided by the centre augment the production and managerial efficiencies of the client SMEs, especially start-ups, and thus increase their productivity. To summarize, various resources must be available for SMEs to adopt new practices that increase their productivity, and policy must focus on ensuring SMEs' access to those resources for such a purpose (Mole, 2002).

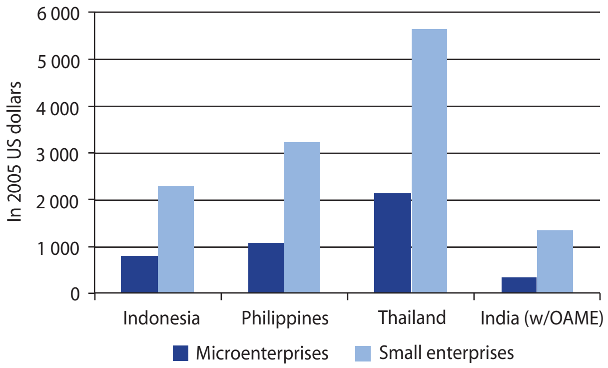
[30] Total factor productivity (TFP) is the portion of output not explained by the amount of inputs used in production. As such, its level is determined by how efficiently and intensely the inputs are utilized in production; sometimes it can be viewed as a reflection of technology and managerial ability. TFP growth is usually measured by the Solow residual in a growth model, and the higher the TFP is the more efficient the firm will be (Comin, 2006).

Figure II.10. Productivity (value-added per worker) differentials by enterprise size (large enterprises = 100)



Source: ADB, 2009.
Note: Enterprise size is measured in terms of number of workers.

Figure II.11. Labour productivity of micro and small enterprises



Source: de Mel and others, 2010.
Notes: OAME = Own-account manufacturing enterprise Micro-enterprises in Thailand are taken here to mean firms that employ 1-15 workers while the small enterprises are those that employ 16-50 workers.

I. Determinants of SME competitiveness

In order for any firm to survive, it must be able to compete. Policymakers constantly search for ways to assist businesses in honing their competitive edge. SME competitiveness can be defined as an SME's (or the national SME sector's) ability to compete for markets, resources and revenues, as measured by indicators such as relative market shares, growth, profitability or innovation levels (ESCAP, 2009b). In this context, competitiveness can be referred to as the relative performance of SMEs in a particular product (or service) market at the national, regional or global level as well as the capability to create new market niches. It reflects the ability of SMEs to sustain superior market positions and profitability, relative to their domestic and international competitors, by (a) producing goods and/or services of high quality and functionality for their customers at low cost and (b) by delivering in a timely manner or (c) for overall superior QCD (i.e., quality, cost and delivery) (ESCAP, 2009b). In addition to competitors and customers, Porter (2008) highlighted the fact that SMEs had to consider three other key market forces when enhancing their competitiveness, i.e., suppliers, potential entrants and substitute products, all of which shape the structure and the nature of competitive interaction within an industry or sector.

Many interacting factors, such as barriers and constraints, influence the competitive performance of SMEs, and they can be broadly divided into external (change or pace of change) or internal (lack of resources) factors (table II.7).

External problems are those principally beyond an entrepreneur's control. They generally involve change, or rates of change, in the business environment in which they operate. For example, a country's central bank may tighten the money supply, resulting in credit rationing that hurts SMEs. Other examples are new business statutes that adversely affect the ability to compete, or new fiscal policies that crowd out private business initiative or investment.

Internal problems are primarily under an entrepreneur's control. They typically arise from a lack of one or more resource, i.e., capital, management ability, technical ability or market knowledge. Also involved is the capacity of an SME to respond effectively to competitors, its flexibility in responding to changing circumstances and its capability to create new market niches. The outlook and capabilities of

Table II.7. Determinants of SME competitiveness

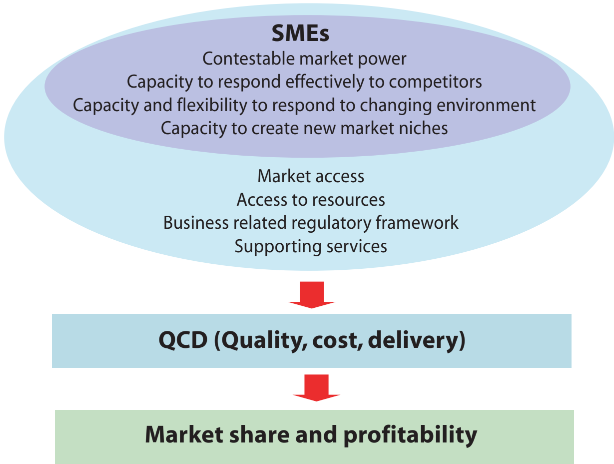
Determinants	Examples
External	
1. Market access.	Domestic markets; penetration of export markets; GSP treatment; trade and investment liberalization (e.g., regional trade agreements, bilateral trade agreements, bilateral investment treaties); and the establishment of foreign operations.
2. Access to resources.	People; skills; capital; finance; physical assets; technologies; knowledge; and supply of raw materials.
3. Regulatory framework which conditions business performance.	The processes of business registration and licensing; taxation; competition and bankruptcy laws; property and intellectual property rights; trade, fiscal, monetary and investment policy; legal system; customs procedures; and export/import procedures.
4. Supporting services provided by both public and private organizations.	The quality of physical infrastructure and logistics systems; formal and vocational education; training services; business development services; and professional services such as accounting and legal advice.
5. Consumer demand.	Change in consumer preferences.
Internal	
6. Management and personnel issues.	Lack of scientific management skills; labour shortages; low skills and education of staff; personal commitment and ambition.
7. Capacity to respond effectively to competitors.	Substitutes for products and services; diversified product and service lines; low cost structure; technical and operational discrepancies.
8. Capability and flexibility to respond to changing circumstances.	The availability to access key resources; capacity for process and product innovation; and flexible supply chains.
9. Contestable market power and capability to create new market niches.	Marketing capability and branding; culture of innovation; and customer/market orientation.

Source: Modified from ESCAP, 2009a.

the owner of an SME tend to drive these issues, as they play a crucial role in determining the success of smaller organizations such as SMEs. These internal problems are often an outcome of faulty managerial strategies or practices.

In addition to the above factors, general conditions such as natural resource endowment, macroeconomic conditions and microeconomic factors prevailing in their home countries, affect the competitive performance of SMEs. Figure II.12 illustrates the competitiveness framework, which covers the causal relationship between external and internal determinations of (a) competitiveness, (b) products and services with superior quality, cost and delivery (QCD), and (c) large market share and high profitability.

Figure II.12. Competitiveness framework for SMEs



Source: Authors' compilation.

It is obvious that the national business environment plays a central role in the enhancement of the competitiveness of SMEs, as some nations have succeeded in attaining competitive advantages for their industries while many others have not. The relationship between the business environment and a nation's prosperity is symbiotic. On the one hand, an SME must understand both the advantages and disadvantages of operating in its home nation. These strengths and weaknesses affect its ability (or inability) to create and sustain a competitive advantage. On the other hand, a nation's standard of living in the long term depends on its ability to attain and sustain a high level of productivity among industries in which SMEs compete. In this context, the main goal of an SME's competitiveness strategy, both at the enterprise and the national levels, may be to upgrade current capacity by incorporating new skills and technologies for higher quality and efficiency. This should begin with an analysis of the strengths and weaknesses of the existing business environment, including SME policies, programmes and structures at all levels, i.e., micro, meso and macro. The results of such an analysis will help form the design of efficient policies and programmes needed for increasing the value that SMEs add to the economy.[31]

Competitiveness can also be assessed at the national level (Porter, 1990), where export performance is the single most important indicator, particularly in the Asia-Pacific region. SME competitiveness can be also defined as the SME sector's ability to produce goods and services that meet the requirements of international markets while simultaneously maintaining and expanding real incomes of the nation in the long term (President's Commission on Industrial Competitiveness, 1985). According to the World Economic Forum's (WEF) (2011) Global Competitiveness Report of 2011-2012, two of the 10 most competitive countries are in the Asia-Pacific region, i.e., Singapore and Japan, compared with seven in Europe and the United States.[32] Greater competitiveness allows a developing country to diversify beyond dependence on a few primary-commodity exports and move up the skills and technology ladder, which is essential to sustaining rising wages, and to permit greater economies of scale and scope in production (UNCTAD, 2002). The ability to compete in international markets is usually thought to be dependent on (a) macroeconomic policies and conditions (trade policies, exchange rates etc.) as well as (b) a nation's comparative advantage, i.e., its factor endowment (land, natural resources, labour and capital) relative to other nations. Due to greater competitiveness, a nation may attain a positive balance of trade and rising incomes for its inhabitants. For example, Singapore became one of the most competitive countries in the world by adopting far-sighted policies that invested in institutions and human resources, and by attracting FDI in order to make up for its lack of natural resources and capital (UNCTAD, 2005a).

These determinants of SME competitiveness clearly point towards the important role that governments play in enhancing competitiveness by creating enabling environments, facilitating better market and resource access and providing pro-business regulatory frameworks and business support services (ESCAP, 2009b). A deeper examination of individual economies in the Asia-Pacific region reveals that some of them have not placed the development and growth of SMEs at the top of their national agendas. These economies will need to prioritize the development of SMEs to stimulate higher growth. This can be achieved by integrating SME development into the mainstream of national development plans. Therefore, a proper understanding of the SME sector, especially its values and roles, needs to gain urgency among policymakers and other stakeholders.

[31] Institutional frameworks for SME development vary from country to country. Various government offices in the fields of commerce industry, agriculture, enterprise development, investment and export promotion, quality standards etc. may handle portions of SME policy. There has been a trend to establish a sector-wide SME development agency to implement a coordinated and consolidated national SME development policy and relevant activities. These initiatives include Bangladesh's SME Foundation, Sri Lanka's National Enterprise Development Authority and Thailand's Office of SME Promotion, which the international donor community recommended. Such newly-established SME agencies often lack adequate resources, experience and effective mandates to conduct comprehensive and substantial SME development initiatives in collaboration with other ministries and are thus not fully able to achieve their objectives. For more details of these SME agencies, visit the websites at www.smef.org.bd, www.neda.lk/ and http://eng.sme.go.th/Pages/home.aspx.

[32] The Global Competitiveness Report is a yearly report published by the World Economic Forum. The 2011-2012 report covers 142 major and emerging economies. For more details, visit the website at www.weforum.org/reports/global-competitiveness-report-2011-2012.

In addition, governments could support institutional capacity-building and the development of human resources for new businesses through such policy actions as the provision of a quality formal education system, a technical and vocational education and training (TVET) system, business and technology incubation facilities, consultancy services and cluster development (see chapter VI). As SMEs are relatively disadvantaged compared to large firms, the aforementioned support programmes should all be geared towards facilitating activities for SMEs, which are working to improve their market (ESCAP, 2009b).

J. SME clusters

Industrial clusters have increasingly been recognized as an effective means of industrial development and promotion of SMEs. UNIDO (1999) defines a cluster as "a sectoral and geographical concentration of enterprises which produce and sell a range of related or complementary products and thus are faced with common challenges and opportunities". Another definition is "a group of firms that cooperate on a joint development project complementing each other and specializing in order to overcome common problems, achieve collective efficiency and conquer markets beyond their individual reach" (UNIDO, 1999). Clusters are often located close to equipment and raw material suppliers, independent component producers, subcontractors and final goods producers as well as ports and airports. Suppliers of key business services are also present as are buyers and their agents.

As a consequence of facing the common challenges and exploiting opportunities, SMEs within the cluster sharpen their own competitive advantage. Clusters can allow SMEs to escape the straitjacket imposed by a lack of economies of scale and benefit from a variety of spillover benefits, including access to a wider pool of relatively specialized labour and opportunities to learn about potentially profitable product lines and technologies. In short, participation in a cluster involves elements of both cooperation and competition. Spillovers of knowledge and other intangible benefits are a common byproduct of these firm interactions.

SMEs also see the following advantages in forming or joining a cluster (ESCAP, 2007b):

(a) Collective bargaining power will increase profitability among member firms;

(b) Collective efficiency based on scale will lead to greater supply in the global market;

(c) Collective efficiency based on specialization will increase productivity through product and process improvements, skill upgrades and market knowledge; and

(d) Joint action will lead to systematic collaborations and formation of associations that can provide better access to global markets.

Clusters have existed naturally in many countries and their development has become a policy priority in the past couple of decades in the developing world.[33] In Japan, based on a review of the history of 14 industrial clusters, Yamawaki (2001) noted several different factors that played key roles across different clusters. These include:

(a) The catalytic role played by the emergence of a large enterprise (for example, the general machinery cluster that emerged around Komatsu Corporation, a large producer of construction machinery);

(b) The presence of public research in a standards testing facility (for example, the establishment of a public technology centre in Hyogo in 1984); and

(c) The availability of a pool of workers (for example, the emergence of an apparel cluster in Gifu, which was helped by an abundance of part-time female labour).

Based on a survey of small enterprises in various clusters, Yamawaki pointed out that for many small firms, being part of a cluster had helped them to specialize, absorb new technologies and facilitate their procurement of inputs. Additionally, local government provisions for public testing facilities and research and technology development centres in the cluster were also helpful.

Being part of a cluster also appears to have helped SMEs in Indonesia. Clustering, together with subcontracting relationships with foreign firms, has played an important role in helping many SMEs become successful exporters of furniture and garments. In addition to enabling SMEs to establish links with foreign buyers, clusters also introduce them to a variety of process and product innovations. For example, the metal industry clusters in Ceper (Central Java) and in Pasuruan (East Java) generally meet the above criteria and are considered successful industrial clusters for SMEs (ADB, 2009). In contrast, small enterprises outside the clusters have not been as successful in either entering export markets or diversifying their product lines.

Zhejiang Province in the eastern coastal region of China is considered to have one of the most vibrant SME industrial clusters in China (ADB, 2009). Its growth was fuelled by the clustering of SMEs in specialized industrial zones. Many small towns in China depend on township enterprises for their economic growth. Such enterprises are expected to generate more employment opportunities for the rural surplus labour force (ADB, 2009). A small town's development must be supported by its industry and such support can come from SME cluster enterprises in secondary and tertiary industries. Clustering does not inevitably cause SME dynamism but it does increase its likelihood. Having an anchor firm or firms in the cluster is also crucial. The large enterprise(s) act as the hub of business links in the form of subcontracting, and drive innovation for the member firms.

The private sector should lead cluster development and governments should be a catalyst. Given the weakness of the private sector in many developing countries in Asia and the Pacific, the governments might initiate the process by establishing appropriate cluster support structures. A number of governments in the region are using assistance to clusters as a chief method to instill dynamism. This aid includes adequate regulatory frameworks, infrastructure and logistics, financial facilities as well as various programmes for capacity-building and cooperative technology development and

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[33] Successful examples of SME clustering include the Sialkot Surgical Instruments Manufacturers Association and Sialkot Chamber of Commerce (Pakistan), the Tirupur Exporters Association (India) and the Penang Skills Development Centre (Malaysia).

innovation efforts. A package of policy interventions should be implemented based on a holistic approach for cluster development, including diagnostic study, trust-building, export promotion, marketing support, skills development, technology upgrading, establishing common facility centres and physical infrastructure upgrading.

K. Gender issues related to SME development

Women entrepreneurs, who often run SMEs, do not operate in isolation. They work under the same macro, regulatory and institutional framework as their male counterparts. It is necessary to explore how gender bias embedded in society limits women's mobility, interactions, active economic participation and access to business development services.

Within the Asia-Pacific region, gender equality remains an elusive goal. Women in many developing countries in Asia and the Pacific remain far behind men in enjoying basic human rights, let alone participating with men on an equal footing in economic activities. Even in countries where legal equality is granted to women, their participation in the social, political and economic life of the nation trails that of men. In this regard, UNDP developed the Gender Empowerment Measure[34] that attempts to capture the level of human development, the level of development of women and the extent to which women are free from discrimination in building their capabilities and in gaining access to resources and opportunities (ESCAP, 2005a). Within the Asia-Pacific region, there are disparities both within and between subregions in terms of the Gender Empowerment Measure (UNDP, 2009). The economies in South-East Asia and East and North-East Asia display a more conducive environment for women entrepreneurs to flourish compared to the Pacific and South and South-West Asia which clearly lag behind in terms of women empowerment (table II.8). A possible explanation may be the socio-cultural norms and values shared within a subregion (International Bank of Reconstruction and Development/World Bank, 2012). However, at the same time, clear differences can be seen within some subregions, such as South-East Asia – with Singapore, Viet Nam and Indonesia ranking sixteenth, sixty-second and ninety-sixth, respectively, in the world. These differences reflect the varying severity of challenges facing women entrepreneurs throughout Asia and the Pacific.

Table II.8. Subregional rankings of gender empowerment measure

Subregions	Average Gender Empowerment Measure ranking
Developed economies	24.7
South-East Asia	66.9
East and North-East Asia	75.7
North and Central Asia	80.4
Pacific	95.5
South and South-West Asia	99.6

Source: UNDP, 2009.
Note: Refer to the Explanatory Notes at the beginning of this publication for subregional groupings and their economies in Asia and the Pacific.

The business environment for women also reflects the interplay of different factors that ultimately result in the disadvantaged status of women in society. Accordingly, women generally have lower participation rates in the formal sector compared to men. However, within the informal sector, they often have higher rates of start-ups and growth. These women-led businesses have traditionally been in sectors that are crowded with competitors and characterized by low profit margins and productivity levels (ESCAP, 2006). They are typically small-sized businesses, employ few workers, compete in the light manufacturing sector and generally access fewer resources than male-owned SMEs.

Despite those statistics, women-led SMEs account for 35 per cent of all SMEs within the Asia-Pacific region (MasterCard Worldwide, 2010). On an individual level, women entrepreneurs tend to be highly motivated, focused and competent in finance, and have strong interpersonal skills, general business management skills, high internal control and a strong sense of achievement (Jalbert, 2000). These traits have been responsible for a steady but moderate growth of female-owned SMEs in East and South-East Asian developing countries during the past decade (figure II.13).

Despite these valuable entrepreneurial traits and the growth within the region, women entrepreneurs face additional gender-specific barriers to their enterprises, i.e., credit barriers, lack of experience and training, lack of relevant networks and societal position and difficulty in time management due to family responsibilities (Jalbert, 2000; and OECD, 2004a). The details are explained below:

(a) Credit barriers. Women in particular tend to seek small personal loans because, in general, they tend to start small businesses. Banks do not consider small businesses to be worthwhile because of their slender profit margins. In the best case scenario, banks do not make much money from lending to SMEs, and in the worst case scenario the SMEs fail and expose the bank to credit risk;

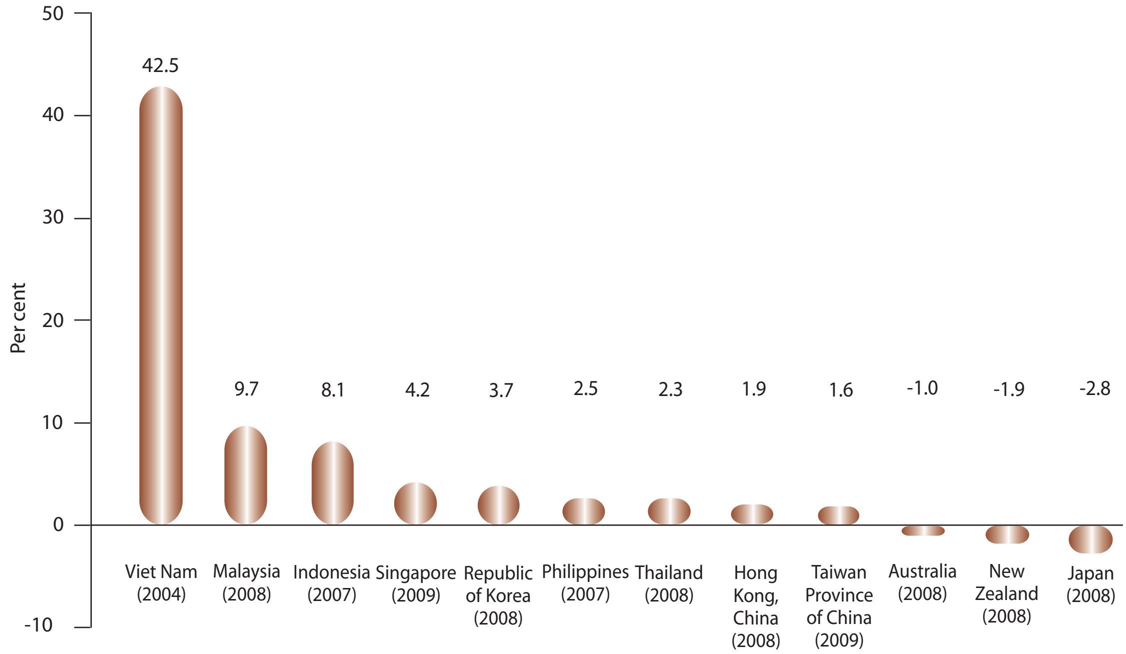
(b) Lack of experience and training. Highly-educated women mainly choose salaried positions; thus, less-skilled women are relatively more likely to be entrepreneurs. Once they do become SME owners, these women have no access to management and technical training;

(c) Lack of relevant networks and societal position. In general, women tend to have a lower social position than men in the Asia-Pacific region, affecting the type of networks available to them. They are less likely to have access to the critical resources, support and information needed to establish and foster enterprises. Yet, the importance of social networks has been acknowledged as a crucial factor underlying the success of new ventures; and

(d) Difficulty in time management. Another recurring theme for women entrepreneurs is competing demands for their time. Women are more prone to not have enough free time to develop either

[34] Gender Empowerment Measure ranks 109 countries based on the extent to which there is gender equity in economic and political representation. It also reflects gender equity in managerial decision-making, professional roles and economic activity (UNDP, 2009).

Figure II.13. Annual growth of female-owned SMEs (Per cent)



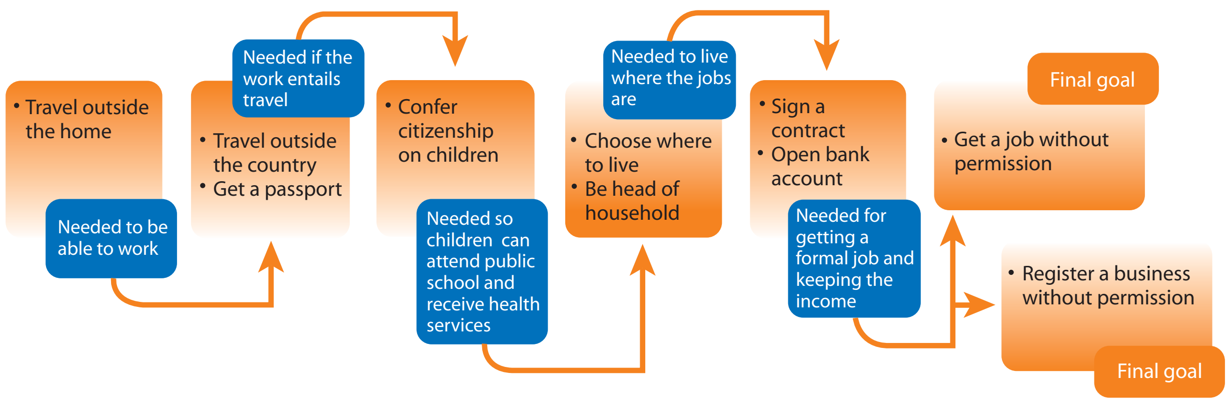
Source: MasterCard Worldwide, 2010.

their entrepreneurial skills or their businesses due to many domestic chores and raising children. Accordingly, they do not have time to meet with institutions and banks for advice and information on credit, attend training programmes to acquire skills or attain market information about potential customers and suppliers (figure II.14).

Overcoming these barriers would allow greater enterprise development among women, leading to their economic empowerment and hence giving them an equal opportunity to support their families and be partners for their progress. It is only in recent decades that policymakers in the region have recognized the importance of female contributions to national GDP and have therefore sought to involve women in public affairs (ESCAP, 2006). These government-led initiatives, while commendable, have often encountered difficulties in making a practical impact. In Viet Nam, for example, the gender equality law was passed in 2006 and came into effect in 2007. It has been found that many of the policies to promote women-led entrepreneurship and increase employment largely only exist on paper (Vietnam Women Entrepreneurs Council, 2007). Similar difficulties exist in Bangladesh where surveys have found that women entrepreneurs are often unaware of government initiatives to promote and support their development (Morshed, 2008).

In principle, opportunities must be the same and equally available to both sexes; however, differences exist in practice. Men are free to participate in all social and business activities, while many women remain with the family. Women entrepreneurs appear to have more difficulty in balancing work and family. Men are more tolerant of risks, while women are more careful and reluctant. Women now have higher levels of education and competencies. Some very successful entrepreneurs are women and their success could be attributed to family support, educational attainment, changing environments, motivation to succeed or the need

Figure II.14. A woman's quest to get a job or start a business



Source: International Bank of Reconstruction and Development/World Bank, 2012.

to sustain themselves and their families.[35] This issue is discussed throughout this publication where appropriate (e.g., women entrepreneurship in chapter IV).

[35] The fields of labour economics and entrepreneurship contain extensive literatures about women's opportunity to participate in the labour force and the travails they face when opening a business. Some relevant articles include: Brush, de Bruin and Welter, 2009; Burda, Hamermesh and Weil, 2007; Terrell and Troilo, 2010; and Weeks, 2009.

Box II.4. Assistance to women entrepreneurs in India

In India, the share of women entrepreneurs in cottage industries such as handloom weaving, handicrafts, coir products and sericulture is as high as 30 to 40 per cent. The Government of India has been promoting entrepreneurship among women, particularly with the aim of encouraging first-generation women entrepreneurs through various training and support services. For example, India has adopted a special strategy to assist women to establish self-employment ventures, providing both forward and backward linkages for marketing facilities. State-run banks are providing microfinance at concessional rates of interest to women entrepreneurs. The Government has also introduced special schemes to subsidize foreign travel for women entrepreneurs to participate in trade exhibitions abroad in order to promote their business in export markets.

Share of women-managed industrial enterprises (in total registered) in India

1987-1988	2001-2002	2006-2007
8% (44 784)	10% (137 534)	14% (215 000)

Source: Ministry of Micro, Small and Medium Enterprises, 2010.

Box II.5. Women entrepreneurship culture in Thailand

Thailand illustrates the important yet veiled role of women in the society. Women comprise 46 per cent of the labour force, 26 per cent of senior officials, legislators and managers and nearly 50 per cent of entrepreneurs in the country (Terjesen and others, 2007). A majority of women are running small enterprises while some lead large enterprises. In particular, women entrepreneurs were playing a significant role in service, tourism and manufacturing sectors in Thailand. Thai women have a more positive attitude towards entrepreneurship than do their male counterparts (Virasa and Hunt, 2007). While a majority of women-run businesses in Thailand are in the informal cottage sector, many are incorporated (36 per cent) and a few (1.4 per cent) are even listed on the stock exchange of Thailand.

Comparison of perceived entrepreneurship between Thai men and women, 2005

Survey results	Male (Per cent)	Female (Per cent)
Business started in the past two years	43	57
Perceive good start-up opportunities	40	60
Fear of failure prevented start-up	35	65
Had knowledge and skills to start-up enterprises	46	61
Entrepreneurship is a good carrier choice	39	61
Successful own business is high status	39	61

Source: Virasa and Hunt, 2007.

Box II.6. Corporate social responsibility and SMEs

The concept of corporate social responsibility (CSR) is aimed at addressing salient socioeconomic as well as environmental issues in a given society. The World Bank (2004) defines CSR as "the commitment of business to contribute to sustainable economic development – working with employees, their families, the local community and society at large to improve the quality of life, in ways that are both good for business and good for development".

For SMEs, the sincere implementation of CSR measures not only facilitates their socioeconomic and environmental responsibilities, but also has a positive impact on their competitiveness (Turyakira, Venter and Smith, 2010). While current evidence has to be viewed with caution, the implementation of CSR measures could stimulate entrepreneurial and innovative ideas, positive changes in the production process, higher motivation among the workforce, cost savings and an overall competitive advantage over SMEs that disregard CSR (Austrian Institute for SME Research, 2007).

Environmental issues particularly in the SME sector have acquired critical importance. As more than 90 per cent of all businesses worldwide fall into the category of SMEs (UNIDO, 2007), one can easily picture their impact on the environment. It is not surprising that SMEs are found to be the most polluting agents in Asia and the Pacific (Institute for Global Environmental Strategies, 2006). Some of the economies in the region, aware of the consequences, have initiated various measures for tackling the growing problem. Creating adequate awareness and promoting due appreciation of CSR among SMEs are recent and very timely phenomena, as the belief that CSR is only applicable to larger corporations is still widely spread among the SME community. Localizing the CSR agenda also deserves emphasis. Dismissing the one-size-fits-all approach and convincingly demonstrating that a tailor-made CSR programme has the potential to meet the specific needs of SMEs could prove the above-mentioned belief wrong (UNIDO, 2007).

To explore the role of government in facilitating the uptake of CSR among SMEs, UNIDO convened an expert group meeting in 2007. The meeting pointed out that governments are mainly involved at three levels: the basic enabling environment; interventions aimed at promoting the spread of best CSR practices; and strategic partnerships (UNIDO, 2007). At each of these levels, governments have a specific role to play and are able to employ a number of tools and strategies to strengthen CSR. The World Bank outlined four of these roles and proposed the inclusion of a fifth (Ward, 2004):

Box II.6. *(continued)*

(a) Mandating – Laws, regulations, penalties and associated public sector institutions that are related to the control of some aspect of business investment or operations;

(b) Facilitating – Setting clear overall policy frameworks and positions to guide business investment in CSR, the development of non-binding guidance and labels or codes for application in the marketplace, laws and regulations that facilitate and provide incentives for business investment in CSR by mandating transparency or disclosure on various issues, tax incentives, investment in awareness raising and research and facilitating processes of stakeholder dialogue (although not necessarily in the lead);

(c) Partnering – Combining public resources with those of business and other actors to leverage complementary skills and resources to tackle issues within the CSR agenda, whether as participants, conveners or catalysts;

(d) Endorsing – Showing public political support for particular types of CSR practices in the marketplace or for individual companies, endorsing specific award schemes or non-governmental metrics, indicators, guidelines and standards and leading by example, such as through public procurement practices; and

(e) Demonstrating (proposed) – Public sector agencies can demonstrate leadership to business in the exemplary way that they themselves engage with stakeholders or promote and uphold respect for fundamental rights. They can demonstrate leadership by carrying out their activities with probity and free of corruption. In addition, they can show leadership in the way that they support transparency about their own activities in relations with external stakeholders.

While this World Bank approach was aimed at governments, UNIDO also worked directly with the SME community. Considering that SMEs constitute the overwhelming majority of all businesses in Asia-Pacific, UNIDO realized the potential positive social and environmental impact that the adoption of responsible business practices by SMEs could make. UNIDO started a triple bottom line demonstration project in 2001 in India, Pakistan, Sri Lanka and Thailand. In addition to facilitating market access for suppliers located in these countries, UNIDO created a framework for export-dependent SMEs that focused on their compliance with environmental and social requirements of global buyers and supply chain partners.

UNIDO also developed its very own CSR methodology called the responsible entrepreneurs achievement programme (REAP). REAP is a management and reporting tool tailored to SMEs that would like to implement CSR concepts and follow the triple bottom line approach. In applying REAP, the project has demonstrated that SMEs can improve their environmental and social performance in a manner that is financially advantageous due to reduced operational costs as well as increases in productivity and international export orders. It remains to be seen how REAP can reach scale and be adopted by a larger number of SMEs.

While the importance of the uptake of CSR among SMEs seems unquestionable due to their enormous cumulative socioeconomic and environmental footprint, the challenges and opportunities for policymakers in this area remain plentiful. Localizing the CSR agenda, policy advocacy and knowledge sharing with the important task of explaining the potential CSR for SMEs is no challenge. If enhanced competiveness and better access to international markets and integration into global supply chains are results of the incorporation of CSR measures into their business model, then more SMEs in Asia and the Pacific should be able to consider CSR, not only as an incentive but as a very valuable corporate strategy.

Box II.7. SME Corp of Malaysia policy framework

The Small and Medium Enterprise Corporation Malaysia (SME Corp) was established in October 2009 through a transformation process of its forerunner, SMIDEC, which was formed in May 1996 to be the premier organization in Malaysia for the development of progressive SMEs. Its main objective is to promote the development of competitive, innovative and resilient SMEs through effective coordination and provision of business support. As the coordinator of all related ministries and agencies, SME Corp provides various business support and information and advisory services for all SMEs in Malaysia. It also serves as the secretariat to the National SME Development Council (NSDC) (chaired by the Prime Minister) and is responsible for the management of data and the dissemination of information and research on SMEs.

In 2010, a total of 226 SME development programmes, with a financial commitment of RM 7.1 billion, were implemented by SME Corp together with related Malaysian ministries and agencies that benefited 614,242 SMEs across all sectors. These programmes are based on three main strategic thrusts that aim to: (a) strengthen the enabling infrastructure; (b) build the capacity and capability of domestic SMEs; and (c) enhance access to finance for SMEs.

Several programmes are provided by SME Corp:

(a) The SME Competitiveness Rating for Enhancement (SCORE) – a diagnostic tool used to rate and enhance competitiveness of SMEs, based on their performance and capabilities. The strengths and weaknesses of SMEs are identified through the SCORE model of the specific industries and recommendations are made for further improvements;

(b) The 1-Innovation Certification for Enterprise Rating and Transformation (1-InnoCERT) – a certification programme to recognize and certify innovative enterprises and SMEs, and to encourage entrepreneurs to venture into high technology and innovation-driven industries. Certified companies will be given fast track access to incentives, including funding for their projects;

Box II.7. *(continued)*

(c) The Annual SMIDEX Showcase – an annual event for SMEs to exhibit their products and services, and for large skills companies and TNCs to seek potential suppliers among SMEs. The yearly event also provides SMEs with opportunities to network regionally as well as exchange ideas and information on technology and innovation;

(d) The One Referral Centre – provides advisory services and information through business counselors, pocket talks, physical and virtual sources of information, product galleries and linkages to other relevant ministries and agencies;

(e) Business Accelerator Programme – designed specifically for the manufacturing, services and agro-industry sectors. After the SCORE assessment, eligible SMEs will receive advisory services from SME Corp that include managerial training, technical advice and consultation to strengthen core business and access to finance;

(f) Enrichment and Enhancement Programme (also known as E^2) – provides microenterprises with business and technical advisory services. It covers manufacturing and manufacturing-related services, services and agri-business;

(g) The National Mark of Malaysian Brand – encourages SMEs providing products and services with high quality, reliability and package standards by giving them the right to carry the Malaysian Brand;

(h) Enterprise 50 Award Programme – recognizes the achievements of Malaysia's SMEs;

(i) Malaysia-Japan Automotive Industries Cooperation (MAJAICO A-1) – for improving the competitiveness of SMEs in automotive industries;

(j) Brand Innovation Centre – provides awareness of the importance of branding and packaging, and training in branding and packaging to SMEs across the country;

(k) SME Expert Advisory Panel – strengthens technical advisory services for SMEs' export business;

(l) Skills Upgrading Programme – enhances knowledge of the SME owners in managing business and skills of their employees;

(m) SME@University Programme – provides a structured learning opportunity to the SME owners, conducted by universities;

(n) SME-University Internship Programme – provides an opportunity for undergraduates to offer advisory services for the improvement of SMEs; and

(o) Business matching – promotes competitive SMEs to become suppliers of parts and components, products and services to large enterprises, TNCs and state owned enterprises.

Source: SME Corp Malaysia, 2011.

L. Summary

SMEs are difficult to define, as different countries and organizations use different criteria, including employee headcount, amount of assets and sales turnover. The specification of SMEs can and does differ by industry sector; what counts as an SME in manufacturing may not be an SME in services. These differences underscore the point that policymakers should use this book as a general reference and tailor their policies to their unique country context.

A typology of SMEs demonstrates that they differ with regard to the stage of economic development in which they operate as well as their own market orientation and stage of the corporate life cycle, and their ability to innovate and use technology. This reinforces the need for policy customization. On the other hand, SMEs commonly face resource constraints due to their small size. These constraints are financial, technological and managerial and should form the basis for shaping SME policy.

Such a policy should focus on improving SME competitiveness and can address both external and internal issues (table II.7) that face small businesses. Of these two categories policymakers are better positioned to handle the former, as the latter is more firm-specific. Policymakers need to streamline the legal and regulatory environments, increase market access and remove uncompetitive practices and expedite access to resources such as financial capital.

Broader policy objectives include the development of SME clusters. Industrial clusters produce agglomeration benefits that spill over to member companies, both large established players and SMEs alike. Policymakers can help this process by providing a robust infrastructure and offering tax incentives to start up in a given area.

Additionally, the inclusion of women in the economy as entrepreneurs is a boon to economic development and women business owners provide the same benefits of productivity and job creation as their male counterparts. Policymakers in various Asia-Pacific nations must challenge and change a number of formal regulations and informal norms in order to allow increased female entrepreneurship. The realm of education is of particular importance; adequate schooling can help women obtain the skills and attitudes they will need to succeed as entrepreneurs.

In concluding this chapter, several key points should be emphasized. First, general agreement exists about the crucial areas for SME development: (a) enabling policy and regulatory framework and infrastructure; (b) entrepreneurship; (c) access to finance; (d) innovation and technology; (e) business development services; and (f) foreign market penetration. The difficulty is that not all donors, development agencies and policymakers adhere to such a comprehensive approach (cf., SME cluster development). Piecemeal activities dissipate scarce resources. In addition, collaboration among the bilateral and international development agencies has been weak and must be enhanced in most developing countries in the region in order to design larger, coordinated and project-supporting programmes; some progress has however been observed, particularly in South Asia (GTZ and Embassy of Japan, Bangladesh, 2006).

The main focus of policymakers on SME development will continue to be on reforms for attaining a business enabling environment, comprising improved policy and regulatory frameworks and an adequate supporting infrastructure. Providing accessible finance has been one of the most critical issues for desired SME growth in the region. Policymakers should also initiate direct support to enterprises on an experimental basis while utilizing SME associations and targeting priority sectors.

This direct support should encompass development of an entrepreneurial culture. Such a culture is essential for SME foundation and growth, but technical assistance often overlooks this factor. A comprehensive "entrepreneurship training programme" should be launched, particularly in rural areas. Special preferences could be given to women and youth entrepreneurs to further their development. Conventional technical assistance to SMEs also neglects innovation through technology development and adaptation, and thus puts SMEs at a competitive disadvantage. Business development services, including marketing support represent another area where assistance would be fruitful. SMEs require professional consultancy on building and maintaining a competitive advantage. Connecting SMEs to regional and global supply chains also merits the attention of policymakers. These chains are instrumental in upgrading human resources and management skills and SMEs benefit enormously when they become a part of such chains.