

1. Introduction

Asian enterprises have been hit hard by the global economic crisis. While the initial impact has fallen heavily on firms dependent on exports, the effects of the crisis have begun to spread into such non-manufacturing activities as construction and retail trade as aggregate demand has weakened.

Yet, in view of the weak outlook for the major global economies, demand for Asia's exports is likely to recover only gradually, and there will be less tolerance for wide current account deficits in the United States and elsewhere. Asian economies are therefore unlikely to be able to export their way out of this slump, as they did after the 1997/98 Asian financial crisis. Some countries as a result need to accelerate the *rebalancing* of economic growth toward domestic sources, a process in which the region's small and medium-sized enterprises (SMEs) can play a crucial role.

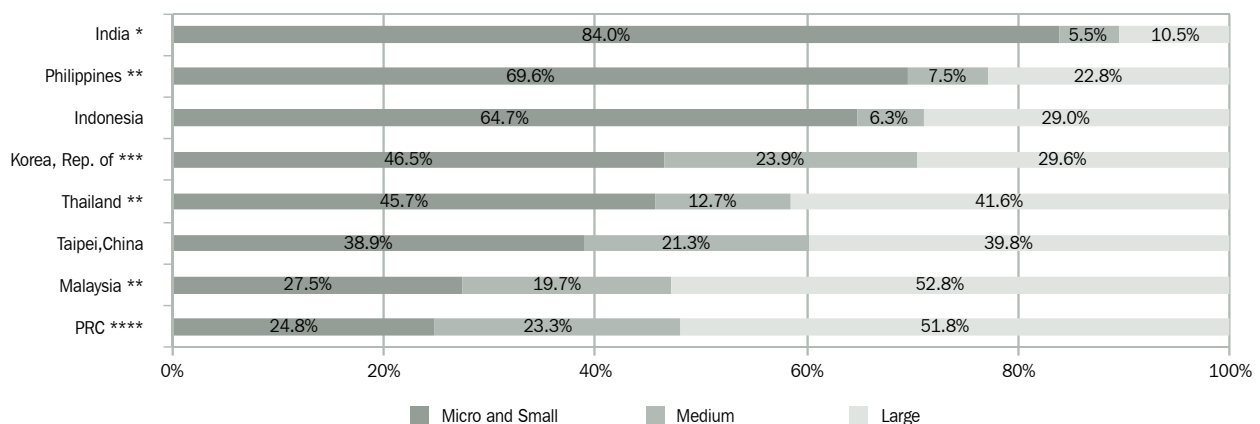
A large share of Asian workers—clear majorities in many countries—are employed in SMEs, especially when these include microenterprises (see, for example, Figure 1.1 for the case of manufacturing in selected economies). Thus their productivity, the earnings they generate, and the wages they pay matter crucially for general living standards. Steps to spur their adoption of productivity enhancing technologies and diversification into modern production activities will be important in lifting domestic demand by providing well-paid employment. In this way, the crisis provides an opportunity to think hard about fostering dynamism among SMEs.

This chapter first presents evidence from a variety of sources to describe the actual and expected impact of the still-unfolding crisis on enterprises and workers. In particular, it examines the impact of the crisis as it has unfolded through the trade channel. It is admittedly too early to rigorously describe the impact—analysis based on micro-data from large-scale enterprise and labor force surveys before and after the crisis broke will probably take at least another year if not longer. But it is possible to use recent industry-level data on exports and micro-data from enterprise surveys and labor force surveys carried out before the crisis to infer the probable impacts on different types of enterprises and workers.

Later sections then take a longer-term view and describe the nature of enterprises in Asia and how public policy can improve enterprise performance, especially of SMEs. The analysis reveals several important features of Asian SMEs that will help better design policy and achieve the above goals.

It is important, for example, to distinguish microenterprises from SMEs. Employing five or fewer workers, typically operating in the informal economy, and accounting for as much as 30% or more of nonagricultural employment in many countries in the region, microenterprises may have limited potential in generating good jobs and serving as engines of growth. This is not to suggest that policy should neglect micro-entrepreneurs. Assisting microenterprises can be an important way to alleviate poverty, and some micro-entrepreneurs have considerable potential to expand their businesses and should be helped in doing so.

Figure 1.1 Share of Manufacturing Employment by Enterprise Size-Groups (%)



Notes: Micro and Small: 1–49 workers in all countries except Thailand (1–50 workers); Medium: 50–199 in all countries except Thailand (51–200 workers); Large: 200 or more workers in all countries except Thailand (more than 200 workers)

* India's manufacturing employment includes workers in own-account manufacturing enterprises (OAME)

** Includes imputation for the self-employed based on differentials between labor force survey and enterprise survey/census data

*** Data on Korean microenterprises are not available

**** Adds the 5.9 million self-employed described in Box 3.1

Source: Authors' estimates. See Box 3.1 for details.

Nevertheless, the big gains in growth and jobs are likely to come from understanding how public policy can help SMEs become more productive. In particular, while the data examined in this chapter indicate that, on average, wages and labor productivity tend to rise as enterprises get bigger, this does not mean that policy should bypass smaller enterprises in favor of encouraging large enterprises. The policy challenge is instead to understand whether something is holding back SMEs and what to do about it.

SMEs often operate under difficult circumstances. They are especially disadvantaged when it comes to access to finance, and often feel the brunt of weak infrastructure. Faced with erratic power supply they are less likely to be able to purchase their own generators. In a similar way, poorly designed regulations and policies can constrain SMEs by diminishing their incentives and/or ability to grow. Finally, market failures due to learning externalities and missing markets can impinge strongly on the adoption of new technologies by smaller firms.

Under the right conditions, SMEs can be quite productive. The average small enterprise in the Republic of Korea (Korea) and Taipei, China, for example, is far more productive than the average large enterprise in India or Indonesia. Additionally, within countries, small enterprises linked to large enterprises through subcontracting networks or to dynamic and profitable markets—such as through global production and distribution networks—can be productive and pay well relative to other small enterprises. Smaller enterprises can also be particularly flexible in trying untested technologies and in developed countries have been found to be important in fostering dynamic efficiencies within industries.

How then should public policy assist SMEs? This chapter notes that while country context will often determine the specific factors that constrain SME dynamism, and thus the nature of public assistance, two issues which require special attention virtually everywhere are (i) improving SME access to finance; and (ii) helping SMEs adopt new technologies and access new markets.

On the first point, recent international experience suggests that one of the most important ways governments can increase access to finance is to improve the institutional underpinnings of financial transactions by strengthening creditor rights, defining property rights so property can be used as collateral for credit, and enhancing credit registries and systems to screen borrowers. They can also improve the informational infrastructure that underlies the working of financial markets.

To help firms adopt technologies and enter new markets, meanwhile, government can provide information on improved production methods, products, and markets, technical support services, and vocational training. They can also foster links between SMEs and large enterprises and encourage cluster-based development by exploiting the fact that many enterprises that make and sell related or complementary products are grouped in close proximity, often with their suppliers and buyers.

More generally, recent experience suggests that discovering the obstacles to growth and diversification, as well as determining the policy interventions that would best remove them requires a close collaboration between the private sector and government. Moreover, in view of the uncertainties associated with the ultimate efficacy of a given intervention, adopting more of an experimental mindset toward policies—combined with rigorous evaluation—can help find policies and programs to encourage the growth and dynamism of Asia's enterprises.

The remainder of this chapter is organized as follows. After looking at the affect of the global economic crisis on Asia's enterprises in the next section, Section 3 examines the types of enterprises in which developing Asia's workers are employed with, the discussion organized around the size structure of enterprises.¹ The data indicate that a large share of nonagricultural employment in many developing Asian economies takes place in the context of small enterprises operating with low productivity and generating relatively low incomes for their owners and workers (even when we exclude microenterprises). For purposes of public policy, two related questions are particularly relevant. First, is something keeping small enterprises from becoming larger? Second, how can smaller enterprises become more productive? Section 4 sheds light on these two questions by describing the factors that may explain enterprise size and its distribution. Section 5 then provides a short introduction to public assistance provided to SMEs, leading into the discussion in Sections 6 and 7 of access to finance, and technology and innovation related issues. Section 8 presents a general discussion of recent debates on industrial policy issues, motivated by recent work on structural transformation—that is, the process by which countries and enterprises move from the production of traditional goods and services to more diverse and modern goods and services. Section 9 concludes.

1 The terms enterprise, firm, and establishment are sometimes used interchangeably in this chapter, although, strictly speaking, they are distinct concepts. An establishment is a single physical location at which business is conducted or where services or industrial operations are performed. An enterprise or firm is a business organization consisting of one or more domestic establishments under common ownership or control. For companies with only one establishment, the enterprise and the establishment are the same.