

5. Assisting SMEs

Virtually all developing Asian countries assist SMEs in some way, including, among other things, through intervention in finance (encompassing not only efforts to improve SME access to finance, but also to lower the cost of finance) and the provision of various types of training for workers and entrepreneurs, technology extension services, marketing assistance, and business development services.

Several reasons explain the focus of special policies and programs on SMEs, over and above the simple fact that they account for a large share of total employment. Beck et al. (2005) suggest there are three: (i) SMEs are believed to be more labor-intensive than larger firms, and as a result, growth through an expansion of small and medium enterprises should generate more jobs than growth driven by an expansion of large enterprises; (ii) SMEs are believed to enhance competition and entrepreneurship—special assistance to SMEs can have positive spillover for the economy as a result of greater competition and entrepreneurship; and (iii) SMEs can be just as, or even more productive than larger firms, but credit constraints and various institutional failures that impinge on them especially severely hold them back. Since alleviating credit constraints and institutional failures takes time, special assistance can be a useful second-best approach, according to this argument.

But as Beck et al. (2005) point out, some of these views are contested. For example, while small enterprises may indeed create more jobs, they may also *destroy* many jobs. Studies examining the relationship between enterprise size and the *net* creation of jobs suggest that there is no simple and systematic relationship holding across countries and over time. For example, while the evidence described from Audretsch (2002) and reported in Box 3.4 indicates that SMEs were net creators of jobs in the United States, studies of other regions can show different results. Table 5.1 breaks down the total change in manufacturing employment over about 5 years in the contribution of small, medium, and large enterprises for Korea and the Philippines. While SMEs added significantly to employment growth relative to large enterprises in Korea the opposite was the case in the Philippines. In any case, the quality of jobs generated by small enterprises (as measured by average wages) may be low (see Sections 3.1 and 3.2).

As for SMEs enhancing competition and entrepreneurship, it is quite likely that there is something to this argument, but qualification is needed. In particular, as some analysts have argued, a distinction needs to be made between *subsistence* entrepreneurs and *transformative*

entrepreneurs. As noted in Section 3, many entrepreneurs of the smallest enterprises may well be of the former type.

Table 5.1 Decomposition of Employment Growth by Enterprise Size-Groups

	Micro	Small	Medium	Large	Total	Period
Korea, Rep. of	n.a.	8.3%	2.7%	0.6%	11.6%	1999–2004
Philippines	-1.2%	-3.7%	-1.4%	1.6%	-4.7%	1998–2005

Note: Micro: Philippines (1–9 workers), Small: Republic of Korea (5–49 workers), Philippines (10–49 workers); Medium: Republic of Korea (50–199 workers), Philippines (50–199 workers); Large: Republic of Korea (200 and above workers), Philippines (200 and above workers); n.a. = not applicable;

Decomposition of employment growth is as follows:

$$\frac{\Delta E_{TOTAL}}{E_{TOTAL}} = \frac{\Delta E_{micro}}{E_{TOTAL}} + \frac{\Delta E_{small}}{E_{TOTAL}} + \frac{\Delta E_{medium}}{E_{TOTAL}} + \frac{\Delta E_{large}}{E_{TOTAL}}$$

Where:

- E_{TOTAL} = Total manufacturing employment
- E_{micro} = Employment in microenterprises
- E_{small} = Employment in small enterprises
- E_{medium} = Employment in medium enterprises
- E_{large} = Employment in large enterprises
- Δ = change

Sources: Authors' estimates based on Annual Survey of Philippine Business and Industry (Philippines) and Report on Mining and Manufacturing (Republic of Korea).

Nevertheless, the notion that SMEs are especially disadvantaged in certain areas is not easy to refute. It is interesting to note that of the many factors that constrain SMEs across countries (and even across regions within countries)—credit market imperfections that penalize small entrepreneurs more than larger ones, and technology-related issues (the use of outdated technology)—are highlighted just about everywhere. Table 5.2, which describes constraints deemed important in various developing Asian countries, illustrates this point well.

In the remainder of this chapter, we consider the finance- and technology-related constraints to SMEs, among other things, examining whether and how disadvantaged SMEs are in their access to finance and adoption of new technology, and the assistance governments have provided. But it is important, first, to acknowledge that our knowledge about the *effectiveness* of SME assistance—what types of programs and program designs are truly effective—is relatively weak. Given that this weakness spans the broad spectrum of SME interventions, and the imperative for improving the situation, we first discuss this issue in some detail.

Assessing SME Assistance

While individual assistance programs and country experiences vary considerably in their scope and design, many of the programs to support SMEs have common weaknesses. First, the programs can suffer from a multiplicity of objectives, some of which may be contradictory. In particular, there is often conflict between social and economic objectives.

Table 5.2 Constraints Facing SMEs in Asian Developing Countries

Country	Raw materials	Marketing	Finance	Energy *	Information	Technology & skill	Infrastructure	Tax	Inflation	Market environment **	Labour issues
Indonesia	✓	✓	✓	✓							
Philippines		✓	✓		✓	✓					
Viet Nam			✓			✓	✓			✓	
Cambodia			✓	✓		✓				✓	
Lao PDR	✓		✓					✓	✓		
Thailand	✓	✓	✓			✓					
Malaysia	✓		✓		✓	✓					
Brunei Darussalam		✓	✓		✓	✓					
PRC		✓	✓			✓	✓				
India		✓	✓				✓			✓	
Pakistan		✓	✓							✓	✓
Bangladesh			✓	✓		✓				✓	
Nepal		✓	✓			✓				✓	

PRC = People's Republic of China; Lao PDR = Lao People's Democratic Republic.

* includes electricity, ** includes regulations, restrictions, legal framework, law and order, and discriminatory policies in favor of large enterprises and multinational corporations.

Source: Tambunan (2008).

Second, often no single department controls or coordinates SME promotion policies. As recently as 2004 in Cambodia, for example, there were as many as 25 different ministries and organizations with their own SME promotion strategies and policies. Few officially coordinated their promotion activities or shared information, resulting in considerable duplication of data collection and often redundant strategies (Bailey 2008).³¹

Finally, and perhaps most importantly, SME programs have not been subject to rigorous evaluation. There are at least three important elements of evaluating SME programs (World Bank 2008): (i) an assessment of the cost effectiveness of the support; (ii) an assessment of the impact of the support program on intended beneficiaries; and (iii) a consideration of the 'general equilibrium' effects. While the third element is no doubt quite complicated, a reading of the relevant literature indicates that rigorous and credible evaluations of even the second element have typically been absent.

The impact of programs to support SMEs has often been measured by the inputs, for example, the amount spent on providing various services, the number of loans granted by guarantee or subsidized credit programs, the number of workers trained in education programs, and so on. But there have been few attempts to measure the impact of interventions on the ultimate targets—the SMEs. This partly reflects the difficulty of measuring those effects on businesses. Hallberg (2000) suggests that monitoring and evaluation should focus on (i) institutional performance, with indicators of outreach, cost-effectiveness, and financial sustainability; and (ii) on market development, with indicators for SME awareness of and willingness to pay for services, prices of services and the subsidies

necessary, elasticities of demand and supply of services, and transaction costs and market structure.

The failure to assess the impact of interventions also reflects a lack of integration of evaluation into program design and a commensurate allocation of resources for evaluation. Evaluation must be built into SME program design and done in a manner that articulates the targets of the initiative and the causal relationships inherent in the design (Oldsman and Hallberg 2003).

The potential benefits and insights from rigorous evaluation are likely to be high. As argued by McKenzie (2009), this is strongly suggested by the recent experience of rigorous evaluations involving microenterprises, micro finance, rainfall insurance, and regulatory reform; it is worth going over some of these studies in a little more detail. Consider the work on microenterprises and the self-employed carried out in Sri Lanka by de Mel, McKenzie, and Woodruff (2008a, 2008b, 2009), some of which has already been described in Section 3. Through careful baseline surveys of micro-entrepreneurs that captured information on entrepreneur characteristics (including measures of cognitive ability and attitudes towards risk, and others) and the subsequent randomized provision of cash and equipment grants to a subset of sample micro-entrepreneurs, the authors have been able to shed light on several issues of importance to development practitioners and policymakers. First, the profitability of the average entrepreneur increases as a result of cash and equipment grants, challenging the view that microenterprises have no scope for growth.³² Second, the impact on profitability of cash grants, which are cheaper and easier to administer, is the same as that of equipment grants. Finally, not all micro-entrepreneurs are equal. Indeed, only between one quarter to one third of microenterprise owners display

31 Fortunately, the creation of the SME Development Framework in Cambodia is providing a much sounder platform for assisting SMEs.

32 This result holds for male entrepreneurs.

ability, motivation, and ambition similar to that of owners of larger firms. In particular, while average incomes increased as a result of the grants, it seems unlikely that the average microenterprise owner has much employment creating potential.

Another recent study examines whether adding business training to a Peruvian group lending program for female micro-entrepreneurs improves outcomes for the entrepreneurs and the institution providing the credit (Karlan and Valdivia 2007). The methodology uses the randomized experiment approach and provides business training to a subset of the micro-entrepreneurs receiving credit. Contrary to the doubts of some practitioners regarding the value of such business training, the findings indicate that basic business training can lead to higher profits. This is true even when those receiving the training are experienced micro-entrepreneurs. Moreover, one of the findings runs contrary to the view that business development services should be rendered at market prices (or close to them). The returns to the business training provided in this study turn out to be larger for those participants who expressed least interest in the training prior to receiving it. In other words, when the value of services provided is unclear to entrepreneurs—especially likely to be the case for relatively inexperienced entrepreneurs—those for whom the impact may be greatest may be least likely to join if fees are involved.

Finally, recent evaluation studies on the provision of insurance to poor farmers provide several important policy lessons. A widely held view among economists and practitioners is that a reluctance to take up credit among farmers and micro-entrepreneurs may be due to the absence of an insurance market. Farmers subject to the risks of variation in rainfall may be particularly susceptible to this. From a policy perspective, the key question is whether offering rainfall insurance increases the uptake of

credit by farmers. As it turns out, a common finding across the few studies that examine this issue is that there is low uptake of insurance products. What is particularly useful for policymakers is that the studies are able to suggest ways to increase uptake, including specific suggestions on the design of insurance contracts and the structure of payouts, bundling insurance products with loan products, and efforts at improving financial literacy.

Extending rigorous evaluation to SMEs is a natural next step. But clearly, cost is a key obstacle (Oldsman and Hallberg 2003). For example, while the provision of \$100–\$200 grants or business training to a few hundred micro-entrepreneurs as part of a randomized evaluation study is not hugely expensive, such amounts probably fall well short of what would be required for interventions intended to evaluate SMEs. Bloom et al. (forthcoming) are looking into whether better management practices improve the productivity of mid-sized firms in India (Box 5.1). Part of their research design involves randomized interventions for a subset of firms with on-site management consulting services provided by Accenture, a global management consulting, technology services, and outsourcing company. Consulting services do require investments by all parties. For instance, manufacturing firms are required to make their staff available to meet with supply chain or process consultants so that knowledge transfer can occur. These services do not come cheap. Nevertheless, the benefits of getting program and policy design for SME assistance right should pay off well, given the much larger impact SMEs can have on aggregate productivity and employment generation, as compared to microenterprises. Indeed, in areas such as SME lending policies, trade credit policies, management training, and sector specific technical assistance, programs ripe for rigorous evaluation have been identified (McKenzie 2009). What is required is a commitment by governments and donors that fund these programs.³³

33 In the absence of a serious commitment by governments and donors, researchers will have to rely on available survey data and administrative data and exploit non-random methods for teasing out the impact of various programs or policies.

Box 5.1 Management Intervention for Mid-sized Firms in Maharashtra, India

If modern management practices improve firm productivity, why are they not yet universal? One meta-hypothesis is that modern management practices are technologies which reflect a body of knowledge and capabilities, and hence they diffuse slowly across firms and countries. Technologies diffuse slowly for several reasons, each of which offers a potential explanation for the relative lack of modern management practices in developing countries.¹ In an earlier joint LSE-McKinsey-Stanford survey of around 4,000 firms in Europe, Asia, and the US, Bloom et al (2007) found that management practices of almost 500 medium-sized Indian manufacturing firms were poor on average. For example, in many cases, Indian managers had little information on production processes, no system for continuous improvement, disjointed targets and ineffective incentive systems. All these factors could conceivably have major repercussions on productivity, profitability, and firm growth.

Research Design

The research design of this project is addressed to resolve some of the implications posed by the bad management practices in India and uses a randomized experiment involving mid-sized textile firms in the Indian state of Maharashtra and working in collaboration with the global management consulting firm Accenture. The survey frame is the population of about 1,000 firms in garments and textiles manufacturing in the Indian state of Maharashtra with from 100 to 5,000 employees.

Treatment group firms will receive intensive on-site management consulting services, provided by Accenture's Mumbai office, for five months designed to upgrade their core management practices around operations and human resources, while a control group will receive only a basic four-week management diagnostic. The intervention is focused on improving five distinct aspects of management practice in a prioritized and sequential manner. Key focus areas include quality control, supply chain management, inventory, production and human resources. Together with intensive high-frequency data collection on the most relevant aspects of operational and financial performance, this design facilitates two essential analyses:

- The comparison over time of the treatment group and the control group will allow estimation of the impact of improved management practices on firm performance;
- A systematic analysis of the participating firms' management practices, and in particular of the root causes of non-adoption of modern management practices, will help pinpoint the key reasons for the slow diffusion of the latter through emerging market economies.

1 First, firms may not be aware of the existence of a new technology or may not know how large the benefits of a new technology are. Second, firms may not know how to implement a new technology, which may require access to a local supplier of expertise and a costly period of learning-by-doing. Third, firms may need complementary inputs in order to use a technology profitably. Fourth, adopting a new technology may require large up-front expenditures, which may be difficult if firms are credit constrained and are not profitable enough to finance the investment from internal cash flow. Fifth, competitive pressures may drive technology adoption, so that firms in highly uncompetitive markets may face little or no pressure to adopt better technologies. Sixth, new technologies may be blocked by legal or regulatory factors. For example, it is possible that regulatory constraints on hiring and firing prevent firms from adopting modern performance-based human resources practices. Finally, it may simply be unprofitable for certain types of firms to adopt modern management practices, the above issues about the availability of complementary inputs aside. For example, sufficiently small firms may not benefit enough from implementing modern management practices in order to overcome the fixed costs of doing so.

Source: Aprajit Mahajan, Department of Economics, Stanford University.