

Do SMEs generate sufficient productive employment for Asia's poor? Some findings and issues in the context of the global economic crisis*

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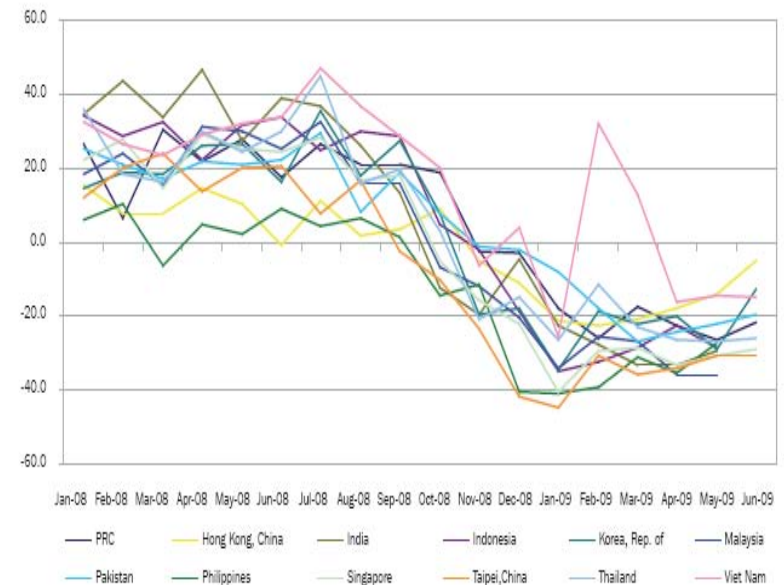
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* Based on ADB Key Indicators 2009 Special Chapter, *Enterprises in Asia: Fostering Dynamism in SMEs*.

Developing Asia hit hard by crisis

- Plummeting exports main effect
- Domestic demand also down due to
 - tight financial markets
 - weak remittances
 - less travel, tourism

Figure 2.1 Manufactured Exports Growth (year-on-year, % change)

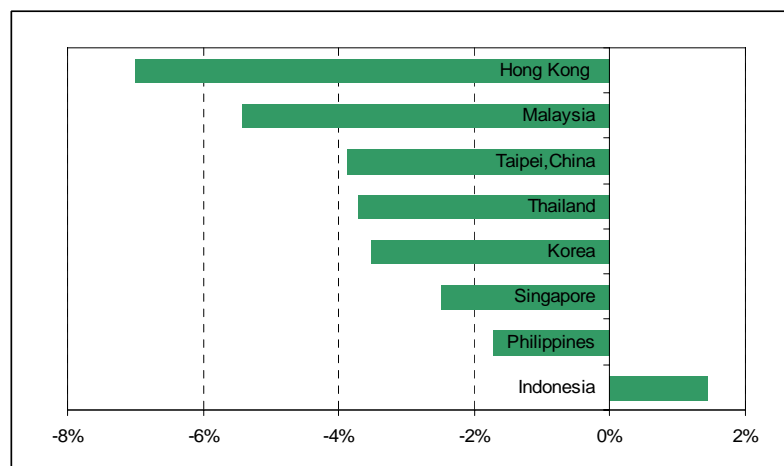


PRC = People's Republic of China
Sources: CEIC Data Company Ltd. and authors' estimates.

Labor market indicators are clearly starting to show the effects of the crisis

- Manufacturing employment has registered the biggest declines
- But workers in construction and wholesale and retail trade services are also feeling the pinch.
- Even where employment is not declining, wages and hours worked are being cut.

Figure 2. Change in Employment in Manufacturing Sector, year-on-year* (%)

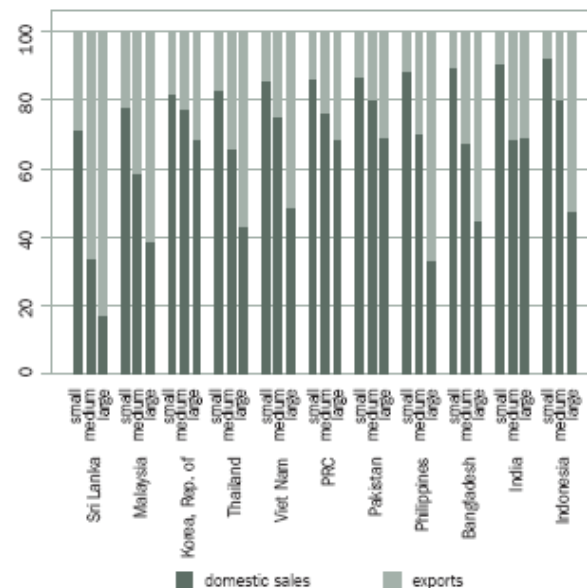


Note: * 1st Quarter 2008 to 1st Quarter 2009 (Hong Kong, Malaysia, Thailand, Singapore); April 2008 to April 2009 (Philippines); May 2008 to May 2009 (Taipei, China & Korea); February 2008 to February 2009 (Indonesia)

Smaller enterprises are more likely to be hit by the decline in aggregate demand

- Pre-crisis surveys show that smaller enterprises' sales are more domestically oriented
- Nevertheless, smaller enterprises do play an important role in exporting in some economies and industries.
- They also play an important role in the global production value chain

Figure 2.10 Export Orientation:
Small, Medium, and Large Enterprises (% of sales)



PRC = People's Republic of China

Note: small firms: 5–49 employees; medium: 50–199 employees; large: above 200 employees.

Source: Authors' estimates based on WBES data.

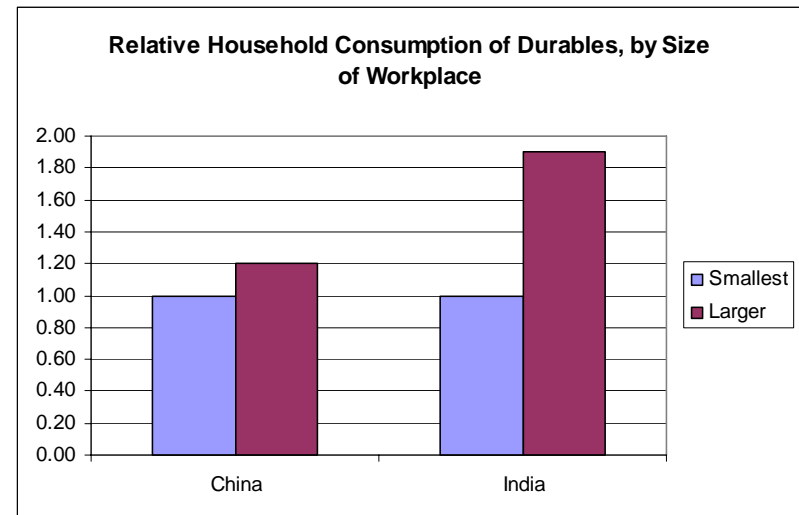


Economies have taken strong steps to help enterprises deal with the crisis

- Expansionary fiscal and monetary policies to boost domestic demand
- Safeguard banking and financial systems
- Specific support to enterprises:
 - Credit guarantees (eg. Hong Kong, China; India; Indonesia; Rep. of Korea; Malaysia; Taipei, China)
 - Worker training (eg. Rep. of Korea; Singapore; Taipei, China)
 - Tax incentives (eg. India, Philippines, PRC, Singapore, Thailand, Uzbekistan)

Nevertheless, the crisis is an opportunity to think about fostering SME dynamism over the longer term

- Less tolerance for wide current account deficits in the US and elsewhere is expected in a post-crisis world.
- Asia's economies need to accelerate the rebalancing of economic growth toward domestic sources.
- The emergence of a large and rapidly growing urban middle class in the region is key to increasing domestic demand.
- The expansions of the middle class will hinge on the dynamism of Asian enterprises, especially SMEs

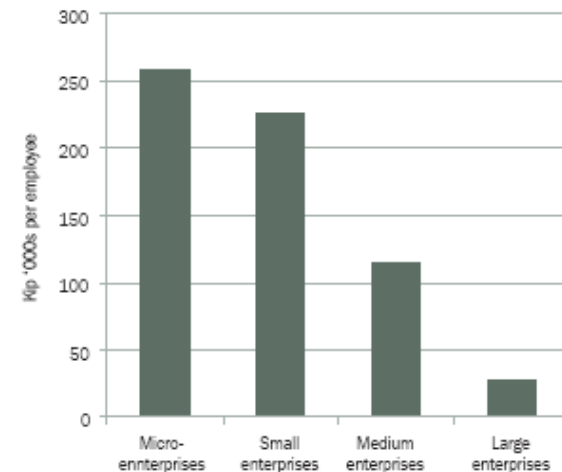


Sources: Staff estimates from Chinese Household Income Survey, India NSSO. For China, smallest workplace category is 1-100 workers, and larger refers to 100+. For India, smallest refers to 1-5 workers, and larger refers to 20+.

SMEs need public assistance

- Help SMEs tackle constraints to growth
 - Infrastructure
 - Access to finance
 - Access to technology
 - Regulatory environment

Figure 4.3 Business Compliance Costs *

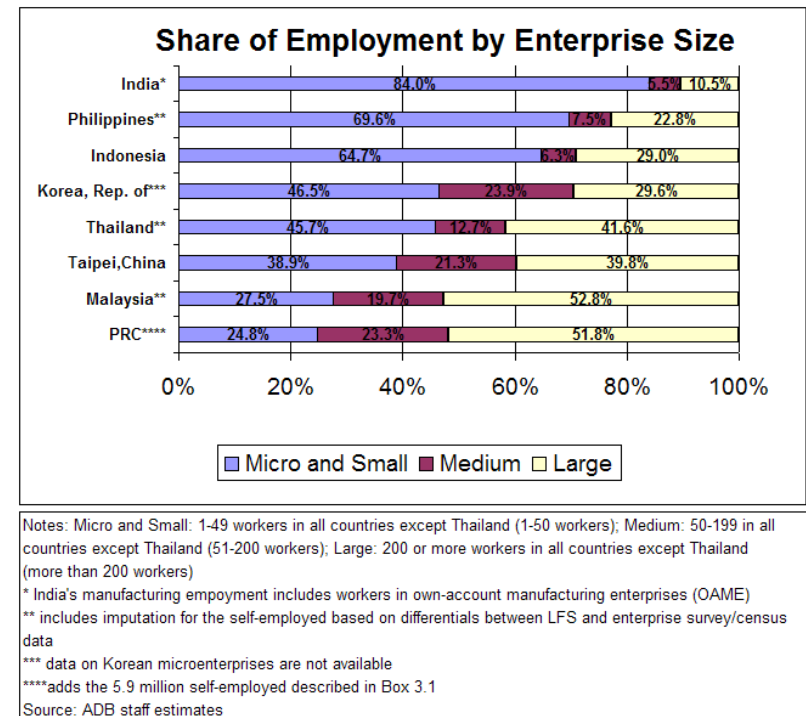


Notes: * Compliance costs per employee of the three main permissions required: enterprise registration, operational permissions and tax certificate. Microenterprises defined as businesses with number of employees between 1 and 4; small firms with number of employees between 5 and 9; medium-sized firms with number of employees between 10 and 99 and large firms with number of employees 100 or more.

Source: ADB (2009b) Lao PDR: Options for a Regulatory Review Program and an Office of Best Regulatory Practice.

The design of public policies for SME support must recognize key features of enterprises in the region

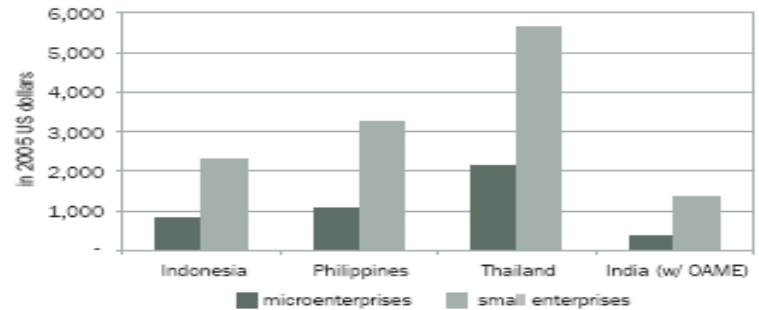
- Small enterprises and microenterprises account for very large shares of employment in the region



It is important to distinguish between them.

- Many microenterprises operate in the informal sector
- They exhibit low (labor) productivity and generate meager earnings for their owners and employees
- Recent research suggests that many microentrepreneurs may not be 'capitalists in waiting'

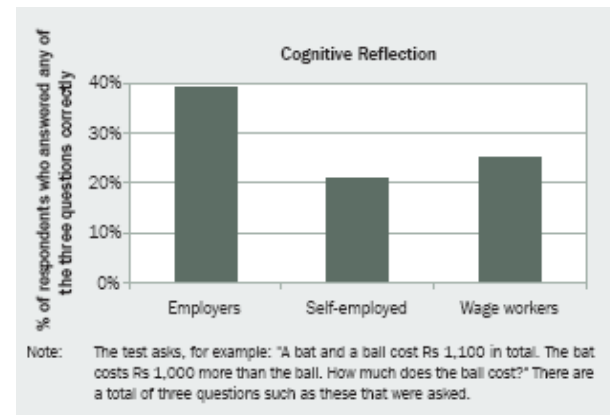
Figure 3.3 Labor Productivity Across Microenterprises and Small Enterprises in Indonesia, Philippines, Thailand and India



OAME = Own-account manufacturing enterprise

Note: Microenterprises in Thailand are taken here to mean those that employ 1–15 workers while the small enterprises are those that employ 16–50 workers.

Source: As in Box Table 3.1.1.



Note: The test asks, for example: "A bat and a ball cost Rs 1,100 in total. The bat costs Rs 1,000 more than the ball. How much does the ball cost?" There are a total of three questions such as these that were asked.

Source: de Mel et al (2008)

Enterprise size matters...

- Large enterprises are more productive and pay higher wages ...
- ...and they are innovative, adopt new technologies, and explore new markets

Figure 3.6 Productivity (Value Added per Worker) Differentials by Enterprise Size (large enterprises = 100)

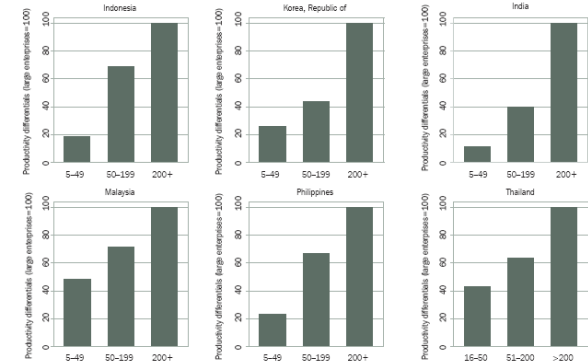


Table 7.1 Asian Enterprises that Undertook Innovation (by firm size, %)

	East and Southeast Asia			South Asia		
	Small	Medium	Large	Small	Medium	Large
Developed a major new product line	32.4%	45.6%	56.9%	36.2%	49.3%	60.8%
Upgraded an existing product line	53.4%	63.3%	72.2%	58.3%	70.9%	75.4%
Introduced new technology that has substantially changed the way that the main product is produced	27.0%	41.3%	54.3%	12.9%	25.9%	37.3%

Notes: East and Southeast Asia includes Cambodia, People's Republic of China, Indonesia, Republic of Korea, Lao PDR, Malaysia, Philippines, Thailand, and Viet Nam; South Asia includes: Bangladesh, India, Pakistan, and Sri Lanka.

Source: Authors' using World Bank Enterprise Survey (WBES) database.

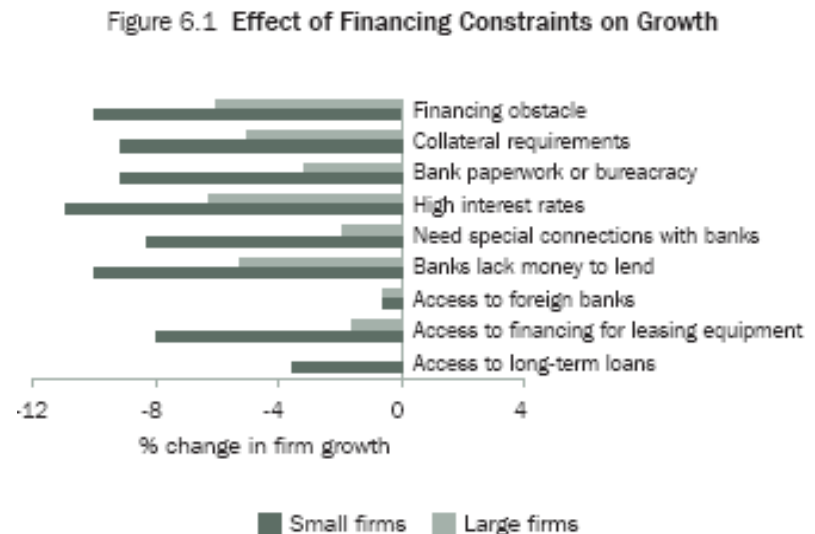


... but policy should not promote the large at the expense of the small

- Example of small enterprises in Republic of Korea
 - Wages and labor productivity are on average at least three times that of *large* enterprises in many other developing Asian economies
- Experience from industrialized countries: small enterprises—especially *new* ones—help create dynamic efficiencies

Fostering SME dynamism: Finance

- SMEs are constrained in access to finance.
- Policy responses include directed credit programs and credit guarantees
- SME finance programs must be rigorously evaluated
- Some broad lessons:
 - Governments should work with commercial forces to correct existing market failures.
 - Governments need not be involved directly in the provision of finance. Where they are needed in is in improving the institutional infrastructure and information infrastructure underpinning the financial system



Source: Beck, Demingüç-Kunt, and Maksimovic (2005) as cited in World Bank (2008) pg.67.

Fostering SME dynamism:

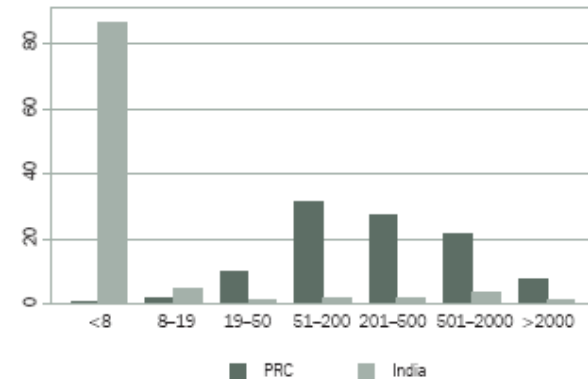
Technology, marketing, and training

- Policy response: Subsidized finance and tax breaks for adopting new technologies, technology support institutions, trade fairs, and training programs.
- As with finance, these programs must be rigorously evaluated.
- But the clear impression one is left with is that similar programs in East Asia have been much more successful than in South Asia
- At a broad level a few elements seem key to explaining the difference in outcomes:
 - Indiscriminate trade protection
 - Forego benefits of 'learning-by-exporting'
 - Lose out on the disciplining effect of imports
 - Weak nature of public-private dialogue
 - Policy-based protection for small enterprises which takes away the incentives to grow (e.g., India vs. Korea)

Policy-based incentives to remain small must be avoided

- Many Indian apparel producers operate at very small scales
- Meanwhile, “reservation” for small producers plus structure of Indian retail markets has enabled the very small to survive.
- “Productivity is low not because tailors are using the wrong technology given their size, but because tailoring firms are too small to benefit from the best technologies and therefore should not exist.” (Banerjee & Duflo)

Figure 4.2 Distribution of Employment by Enterprise Size-Groups in Apparel: India and PRC (%)



PRC = People's Republic of China
Source: As in Box Table 3.1.1.

Spreading Machine



Policy design should be in harmony with key features of production

■ Fragmentation of production

- A growing tendency of 'fragmentation' of production
- Help SMEs become part of the value chain

Fragmentation of production

Before fragmentation



After fragmentation

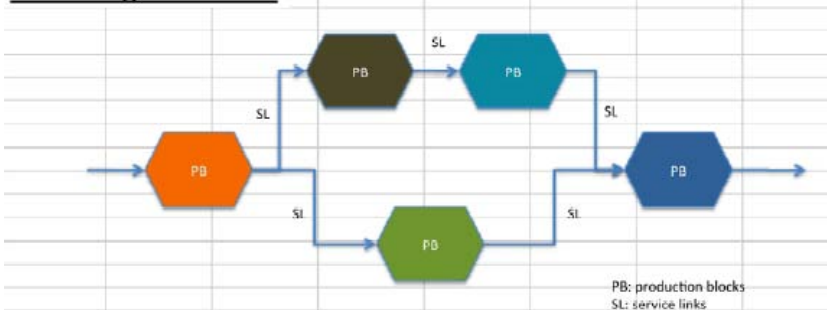


Figure 7.2 Structure of Subcontracting in the Thai Automobile Industry

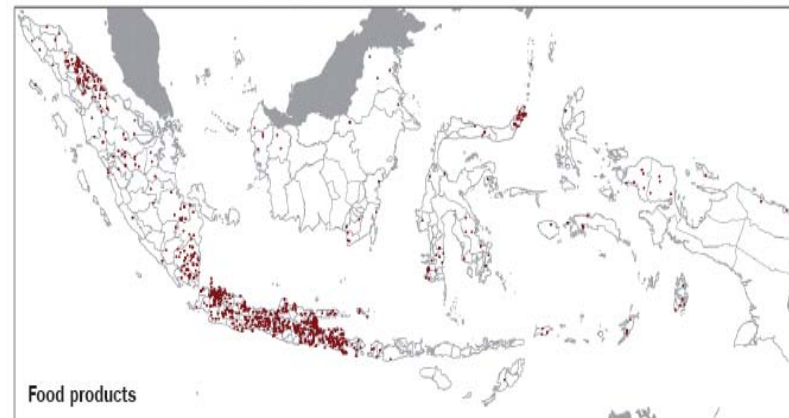
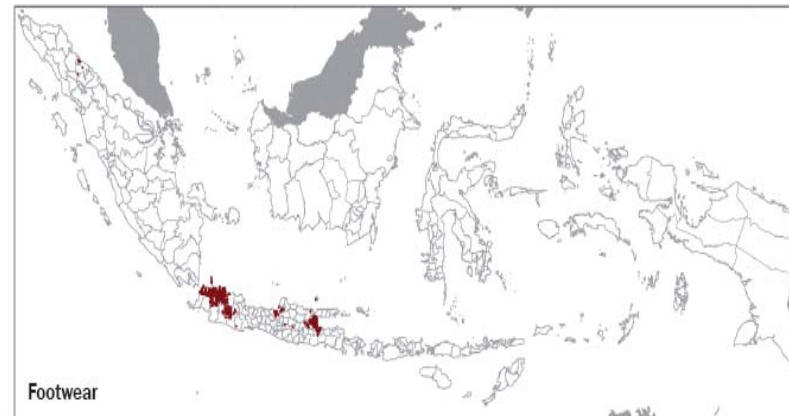


Source: Purnyasavatsut (2008).

Production is often spatially concentrated

- Exploit the spatial concentration of production (especially manufacturing)
- Assist SMEs using a cluster approach; e.g., ADB's City Cluster Economic Development in South Asia (ADB 2009)

Figure 7.4 Distribution of Manufacturing Employment in Footwear and Food Products, Indonesia, 1996

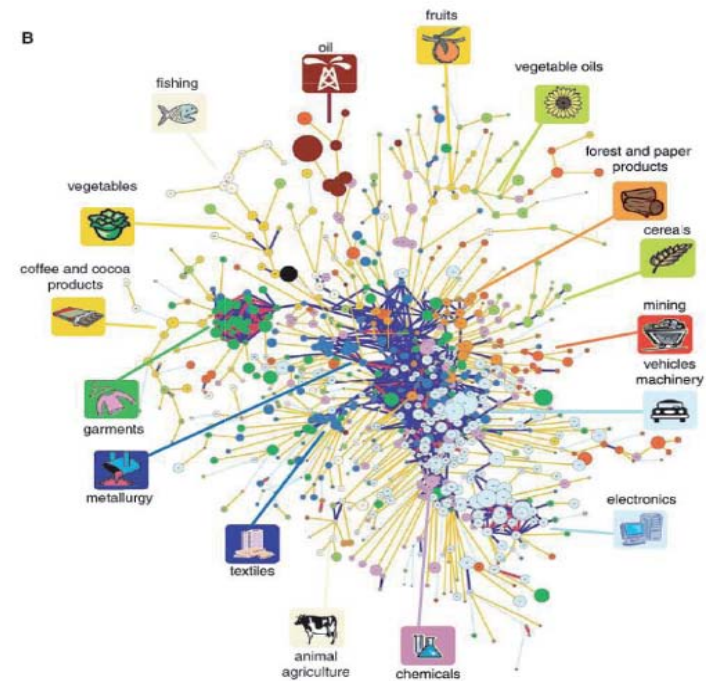


Source: Deichmann et al (2005).

What you produce can matter...with implications for public-private dialogue

- What firms produce (and export) seems to influence how fast the economy diversifies and grows.
- The dense part of the 'product space' is where products are highly interconnected. If you are here, it is easy to move to many other products in the neighborhood.
- Why? Because the capabilities and inputs – private and *public* – required for production vary by product.
- The product space as a *tool for public-private dialogue* for uncovering the most significant obstacles to restructuring, and determining what interventions are most likely to remove them.
- Examples at ADB: Nepal and Pakistan

Box 8.2 continued from previous page

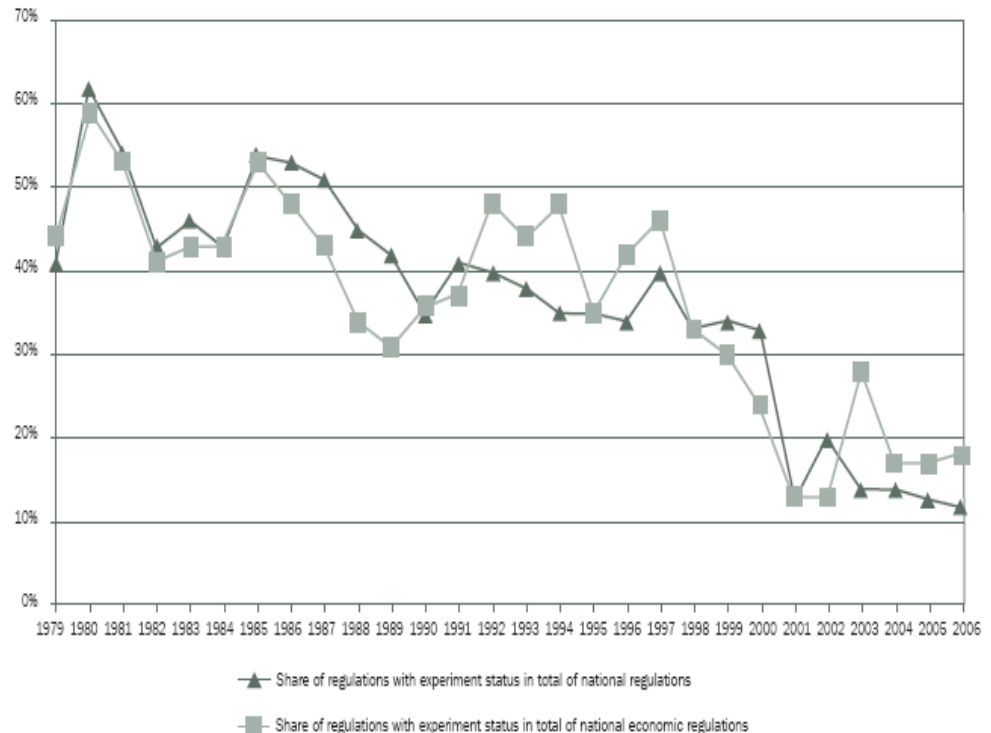


Sources: ADB 2009b; Felipe et al (2009), Hausmann and Klinger (2006), and Hausmann and Rodrik (2006).

A final message: The importance of policy experimentation and evaluation

- *Ex ante*, it is unclear which constraints are truly binding on enterprises, and which interventions will be successful in relaxing these.
- In particular, the importance of local context suggests that the adoption of an experimental mindset is important.
- This mindset needs to be backed by a commitment to rigorous monitoring and evaluation
- Only then can we be more confident about the specifics of policies and programs.

Figure 8.1 Policy Experimentation in the People's Republic of China



source: Heilmann (2008).



Thank you

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