

SMEs' changing role

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- **Export-oriented Asian SMEs had a rough ride in 2008-09 but the outlook is better**
- **SMEs are a crucial source of employment, growth and innovation**
- **Industrial structures are changing, with SMEs playing a more important role than ever**

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This report focuses on the role of SMEs in Asia and the challenges they face from globalisation and technological change, and the rollercoaster world economy.

- SMEs play a critical role in Asian economies in generating growth, employment and exports.
- In general, they comprise the vast bulk of enterprises, and account for at least half of value added and employment.
- SMEs' role in international trade is frequently under-estimated because they are often essential suppliers to larger firms which do the exporting.
- The 2008-09 economic downturn was particularly tough on export-oriented SMEs, but there has been a strong bounce back in the last year.
- Asian SMEs fared better in this downturn than in 1997-08 because Asian banks were less affected by the financial crisis and maintained lending while governments put in place special support facilities.
- New technologies have changed the economics of scale so that the division between small and large firms is changing. Small-firm clustering, as suppliers to large firms, has become increasingly important.
- Fostering a supportive environment for SMEs is critical for development success. Governments have learnt a lot since the Asian crisis, and are increasingly active in providing a positive environment.
- But governments can also be a hindrance to SMEs through excessive regulation and frequent changes in rules.

Important disclosures can be found in the Disclosures Appendix





SMEs in Asia

Asian SMEs went through a sharp downturn in 2008-09, but the damage was limited by the relative health of Asian banks and new government support programmes

SMEs emerging from the crisis

The strong economic recovery in Asia over the last year has helped SMEs emerge from the deep recession and financial tsunami. The crisis was particularly tough on export-oriented SMEs, both on companies directly exporting and suppliers to large companies reliant on exports. But the strong bounce-back in exports as the US inventory cycle turned has seen a return to health. Caution remains however, given uncertainty about the extent of the renewed slowdown in the US and China.

The UPS Asia Business Monitor survey published 5 August found a marked improvement in optimism compared with 2009 (ABM 2010). More than half of respondents (52%) expected greater growth opportunities in 2010, while only 4% anticipated a decline. Among the 13 countries surveyed, SMEs in the Philippines were by far the most bullish on their country's prospects, while Korean SMEs foresaw the fewest opportunities. The top fears of SMEs according to the survey are rising costs, competition, interest-rate hikes and cash flow. In 2009, the overriding concern was the economic downturn.

Overall, the environment for Asian SMEs in this downturn seems to have been less severe than during the 1997-08 crisis; and, indeed for SMEs in major countries, mainly because financing did not tighten as much. This was partly because Asian banks mostly escaped the financial crisis which brought a sharp credit crunch in the US and Europe. Also, strong pro-active moves by governments in Asian countries to support credit provision to SMEs during the crisis played an important role. Finally, in the US, declines in collateral values, particularly real estate but also equipment, have undermined financing for some companies (Bernanke 2010). This has been much less of a problem in Asia.

Over the last 10-15 years, there has been a quantum leap in understanding of the needs of SMEs both among governments and banks. In some countries the 1997-08 crisis was an important catalyst, as it focused attention on the need for a diversified industrial structure, with less reliance on large companies to lead growth. There is now a much greater understanding of the key role SMEs play in generating economic growth, and particularly employment growth.

Meanwhile, new technologies, particularly the internet but also changing manufacturing processes, have transformed the economics of scale, so that the division of activities between small firms and large firms is changing. SMEs are playing an increasingly important role in the economy, reflecting both the increasing demand for tailored products and services and the changing production process for generating them.

There is an increasing recognition of the importance of the clustering of small firms, often supplying one or a few large firms, all integrated in the global production chain. Although SME share of direct exports appears to have declined somewhat to be well below that of large companies, many SMEs make a large indirect contribution as suppliers to larger companies.

Banks are also increasingly able to use technology to support their SME clients. For smaller clients, risk-modelling techniques developed for consumers are increasingly in use, while for larger firms, banks can use tailored solutions delivered by dedicated account managers more effectively than before.



SMEs in Asia

SMEs represent the vast bulk of enterprises and generally account for around half or more of value added and employment

SMEs are a key part of the economy

SMEs typically account for 95% or more of enterprises, 50% or more of formal employment and 30-60% or more of GDP (IFC 2009). The exact numbers vary between countries, though it is often difficult to tell whether this reflects different economic structures or different definitions of SMEs (see below). Their direct share of exports is usually smaller than their contribution to GDP, though it varies widely, from 68% in China to around 20% in Singapore and Malaysia. But indirectly, as suppliers to larger firms which export finished products, SMEs play a much more significant role.

Data on SMEs often includes everything from one-person businesses (better designated as micro-businesses and in some countries excluded from the figures), through small businesses with perhaps 5-50 people, through to medium-sized businesses employing up to 250 people. Their orientation varies substantially too, and they can be roughly divided into three categories. One category is start-ups, with entrepreneurs trying to establish and build new businesses. Some will have limited potential upside, while others could be the large companies of tomorrow. This is an exciting category, accounting for up to 20% of businesses at any one time, though many will fail.

A second type of SMEs, particularly important in manufacturing, is established subcontractors to large firms. Sometimes these are spin-offs, other times they have simply grown with the larger firm, fulfilling a specialist niche and working closely together. Like the dynamic start-ups, these firms are often competing nationally or even globally for business. This category is of growing importance in the global production chain, and underlines that the figures for direct exports of SMEs seriously underestimate their full role in international trade.

The third category, which comprises the majority of SMEs in most countries, includes established small-scale local service businesses, usually with relatively limited growth potential, such as retail shops and restaurants. In emerging countries these can often be low-tech, low-productivity businesses – though by no means all are.

In terms of size, the range of SMEs can be viewed as a pyramid with a large number of single person firms (where they are included in the category) at the base, a lesser number of small firms and a limited number of medium-sized firms towards the apex. Some studies identify a “missing middle” in emerging economies compared with advanced economies. That is, there are many small enterprises and a few large enterprises but not so many medium-sized firms.

However, even these divisions by type or size still disguise a heterogeneous range of businesses, each with different resources and business niches, and each facing a unique combination of local economic conditions and relationships with customers, suppliers, government and creditors.



SMEs in Asia

The economics of scale have changed with the advent of new technologies, particularly the internet

New technologies have reduced the advantages of scale

New technologies have radically changed the economics of small versus large firms in the last decade. Economies of scale are less common now, even in manufacturing processes with new technologies such as computed numerically controlled (CNC) machines that reduce capital costs, and plastics that replace steel. Meanwhile, the development of internet communications has made it possible for firms to outsource virtually any activity that a large, fully integrated firm might undertake, whether it is design, production, sales, marketing, packaging, HR, accounting, etc. As a result, firms can focus on where they add value and outsource everything else.

Economies of scale remain in many areas; moreover, large firms often focus heavily on building a widely respected brand. But this still permits substantial outsourcing, with franchise potentially the ultimate brand-only business, with everything else outsourced, often to small businesses. ICT also permits small firms to co-operate on projects in a way that was much harder to do in the past without physical proximity.

Despite the potential of the internet, so-called “clustering” remains important for small firms, enabling them to gain the benefits of face-to-face meeting, share ideas and new developments and generate a local skilled labour pool. The internet breaks down geographical barriers to an important extent, creating opportunities but also challenges for small businesses.

SMEs are central to growth and development

SMEs generate economic growth by being efficient and competitive; the role of clustering is increasingly important

In the past, economic growth was sometimes viewed as led by a few large, competitive, dynamic companies, able to access capital, embrace new technology and unlock export markets, with a mass of small inefficient enterprises underneath. Whether this was ever a complete picture is doubtful. It certainly does not describe the development of Hong Kong and Taiwan, where small companies always played a key role. New technologies and easier access to finance are making it even less so now.

SMEs play a key role in several ways. First, some small companies grow into medium-sized companies and then become the large companies of tomorrow. In the process of successfully growing they need to be good at what they are doing, in terms of products, technology and management. By accumulating physical capital and developing human capital and skills, they contribute to the country's growth. These dynamic small companies, combined with some large companies, are probably the key drivers of economic growth.

Second, when small firms form clusters, either supplying large firms or competing for final consumers, the concentration of people usually drives innovation and productivity. Other firms quickly follow as best practice spreads. Clustering promotes specialisation and economies of scale. It also makes it easier to organise technical training and, in some cases, may facilitate collective procurement of inputs, lowering costs. Clustering also promotes the development of human capital and can help to alleviate poverty (ADB 2010).

Third, the forces of competition are usually very strong for small companies, sometimes more than for large companies, which breeds a continuing emphasis on efficiency. Small firms have no choice but to be highly cost-conscious and very focused, an attitude that helps allocate resources more efficiently and thereby adds to economic growth.



SMEs in Asia

SMEs are important innovators, particularly for middle- and high-income economies

Small and medium-sized firms are important innovators

It is striking how much innovation comes from successful new companies. SMEs tend to be entrepreneurial, flexible and resourceful and are able to identify business opportunities and market niches based upon their unique products and services. Studies on SMEs in OECD countries suggest that about 30-60% of firms have introduced at least one new or improved product or process to the market, while in some countries small firms are equally as innovative as large enterprises, especially in the service sector (OECD 2002).

For a low-income country, innovation may be less important. Catch-up is mainly about acquiring the physical and human capital to generate higher incomes. Many countries, from Germany in the late 19th century to Japan in the 20th century, have focused on copying what works well elsewhere; China is often seen as doing the same. But for medium- and higher-income countries, innovation is essential and SMEs play a key role.

Of course, large firms have certain advantages in generating growth. They often have more access to information, more people to process it and more capital for investment, making it easier for them to embrace technical change and improved processes. But large firms can also be inefficient, particularly if they face limited competition. They can also become too dependent on state support, either through government limitations on new entrants or cosy government procurement practices. In practice, it is hard to put numbers on whether small or large firms are more important for growth and it remains a source of academic debate.

SMEs increase in importance as the economy develops

There is broad evidence that SMEs become a larger part of an economy as it develops. For example, one study found that, on average, the SME sector accounted for only 16% of GDP in low-income economies, 39% in medium income economies and 51% in high income economies (Ayyagari 2005). In part this is a matter of definition. Low-income economies tend to be dominated by the informal sector, often with so-called micro-enterprises involving one person or a family. But these are typically not counted in the statistics, because they are not registered as businesses.

Still, there is evidence that, even in the advanced countries, the importance of SMEs has increased over the last few decades. This is partly a matter of technology and partly a matter of income. High-income economies tend to produce a much wider range of consumer products and services, encouraging specialist firms to meet the demand. Two other key trends bringing more SMEs into many countries have been privatisation and increased government outsourcing, again encouraging small business.

Of course, an expanding SME sector as income increases does not prove that SME are actually generating more growth than large firms. It may simply mean that a higher income economy naturally has more SMEs, as consumers demand more customised, tailored products, and education levels and entrepreneurial activities rise.

The importance of SMEs increases as economies develop, though the data are sometimes misleading



SMEs in Asia

However, there is strong evidence that SMEs, small firms in particular, make a disproportionate contribution to the creation of new jobs (URS 2010). This finding goes back to the 1970s in the US (Birch 1979), but has since been confirmed in other countries. Moreover, the contribution of small firms to employment tends to be less cyclical than for large firms, helping with the stability of employment. A further attribute is that SMEs tend to use less capital than large companies to create jobs, an especially important point for emerging countries. SMEs therefore have a vital social role in absorbing rising labour forces.

Many Asian SMEs have a strong outward orientation, either directly or in partnership with larger firms

Globalisation is a challenge and an opportunity

Globalisation has a differential effect on individual SMEs depending on their orientation. Many SMEs, particularly in Asia, are already heavily involved in exporting and have a strong outward orientation. Globalisation and the internet revolution have helped them substantially, though competition is, for many, intense. The OECD estimates that 5-10% of SMEs fall in this category, but this estimate goes back to 1997. It is likely higher now, especially in Asia.

For a further 25-50% of SMEs, inward globalisation poses new competitive challenges, with different SMEs from different industries affected in different ways. They need to respond to the challenge by becoming globally competitive. The rest of SMEs are still relatively insulated from globalisation, generally where economies of scale or the importance of a major brand do not apply. Many small companies make a virtue of being local and rooted in the community and have a strong local reputation.

For SMEs, exporting presents particular challenges. Despite tariff reductions over the years, non-tariff barriers can be considerable, including customs procedures, labelling standards and consumer protection. In 2010, several new regional free trade agreements come into force which should open up opportunities, including the ASEAN-FTA and the ASEAN-Australia-New Zealand FTA, which both began in January. Exchange-rate volatility is also a challenge for SMEs, though in the latest crisis the decline in Asian currencies versus the USD was a help.

Governments now put great effort into supporting SMEs; but complex and changing regulations can be a burden

Government can be help and hindrance

In recognition of the importance of SMEs, most governments now put considerable effort into trying to provide support. In Asia, the 1997-08 crisis was a major catalyst for change, as governments re-evaluated their industrial policies and placed more emphasis on flexible and adaptable business sectors (Harvie 2004). Many governments now have support schemes to help with start-ups, training and finance for example.



SMEs in Asia

At the same time, government activities can be an obstacle or burden for SMEs. New regulations, for example, often hit small firms harder than large firms as the costs of compliance can be disproportionately high and compliance diverts limited management resources. Some small firms depend on government contracts, yet procurement rules and procedures can vary unexpectedly. In all this, small and medium firms typically have limited power or ability to lobby successfully, unlike larger firms. In some advanced countries, entrepreneurs are vexed by tax considerations, where income or capital gains taxes are significant. In many emerging countries, formal taxation may not be the problem but “enabling payments” to government officials can be a significant cost.

Academic research casts doubt on whether some of the programmes of government subsidy to small firms really have helped promote growth, alleviate poverty and encourage entrepreneurship as hoped (Beck, Levine 2005). It is impossible to help all companies; any selection process can be unfair or unwise. Moreover, measures giving advantages to small companies over large (e.g., differential tax or exclusion from regulations) provides an incentive to stay small, which is not helpful for economic growth. However, there is better evidence that developing the financial sector and enhancing access to credit is a crucial factor; government policy can help there (Beck 2007).

Economic freedom indices reveal sharp differences

Table 1 below borrows selectively from The Economic Freedom Index published by the Heritage Foundation annually. The overall index covers ten different elements of the business environment. Selected here are the four that matter most to SMEs. Singapore and Hong Kong come out best on these indicators, with Singapore bettering Hong Kong on labour freedom. Both countries do better than the US except in the labour freedom category, where Hong Kong again lags. Korea, Malaysia and Taiwan form a second rank, with Korea and Taiwan falling down on labour freedom and Malaysia on property rights. China, India and Indonesia bring up the rear, with China and Indonesia scoring particularly badly on property rights and India on business freedom.

Hong Kong and Singapore come out best on key measures of economic freedom for SMEs

Table 1: Economic freedom indices

	Business freedom	Fiscal freedom	Property rights	Labour freedom	Average
China	49.7	70.2	20	53.2	48
Hong Kong	98.7	93	90	87.4	92
India	36.3	73.4	50	57.5	54
Indonesia	53.1	81.9	30	50.8	54
Korea	91.9	71.1	70	47.1	70
Malaysia	69.9	84.3	55	71.4	70
Singapore	98.2	90.7	90	98.9	94
Taiwan	83	75.9	70	47.7	69
USA	91.3	67.5	85	94.8	85

Source: The Economic Freedom Index 2010, Heritage Foundation

Note: Score out of 100. Higher is better



SMEs in Asia

The business freedom score is derived from factors such as the cost and time to start a business and obtain a licence. The fiscal freedom score reflects the top tax rate on individual income, the top tax rate on corporate income and total tax revenue as a percent of GDP. The property rights score is “an assessment of the ability of individuals to accumulate private property, secured by clear laws that are enforced by the state”. Finally the score for labour freedom is based on factors such as the difficulty of firing redundant employees and mandated severance pay.

In practice, not all these factors necessarily apply to small enterprises in particular countries, but they are indicative of the regulatory environment. For many small businesses, finding their way through the regulatory burden is simultaneously a burden and part of their skill repertoire. For some, complex or rapidly changing regulation may give them protection against new entrants, thereby aiding profitability. Nevertheless, such regulation is an impediment to economic growth by discouraging enterprise. In some countries, it may have the effect of discouraging enterprises from joining the formal sector, which may leave them cut off from formal financing channels.

Finance is a key issue for SMEs

Ensuring good financial support for SMEs presents special challenges

There have long been concerns that SMEs find it difficult to access adequate finance for growth. In various global surveys, SMEs have reported that the cost of finance is their greatest obstacle to growth and rank access to finance as another key obstacle (OECD 2006). Studies have found that large companies are much more likely than small firms to use bank financing for a new investment and that this is frequently due to lack of availability rather than lack of demand. SMEs need bank services because they lack the cash flow to make large investments, they cannot access capital markets as large firms can and they often lack qualified staff to perform financial functions.

The demand is not simply or even mainly for credit. SMEs need transactional products such as automatic payroll and payment collection, debit cards and currency exchange. They also benefit from advisory services that can help to produce reliable financial statements, develop business plans and select appropriate financial products. From the point of view of banks, SMEs present both a challenge and an opportunity. The challenge arises from the contrast between SMEs (some at least) and large firms. Balance sheets and cash flow are often more opaque with a higher share of intangibles, track records are often shorter, management skills may be more limited and the firm may have limited market power. In addition, the investment a bank may need to make, to understand the business, may be hard to justify for a small client.

Regulatory obstacles can be an important problem for SME finance. Interest-rate ceilings, for example, intended to make lending more affordable, may actually discourage competitive and commercial pricing. In less developed countries, SME enterprises (sometimes of significant size) may remain in the informal sector because of the complex regulatory obstacles to formalisation and so may remain unbankable.



SMEs in Asia

In some countries – China is perhaps best known – the legal arrangements around collateral are often uncertain. Bankruptcy arrangements may be inadequate; the lack of a credit bureau in some countries is also an important impediment. In general, there is evidence that financial liberalisation tends to aid the provision of financial services to SMEs and that foreign banks often play an important role (Brookings 2007).

Recognising these problems, governments have been taking a variety of measures, including reforming existing legal/regulatory barriers, taking actions to develop the SME financing market broadly and intervening in the market directly to jumpstart or incentivise lending to SMEs (IFC 2009).

SMEs are a growing segment of the economy and effective use of new technologies and processes make it easier for banks to provide good service

Opportunity for banks

The opportunity for banks arises because the SME sector tends to grow as a proportion of the economy as the economy develops, and because new technologies make it easier for banks to employ state-of-the-art business models and use customised statistical credit scoring approaches for smaller firms. Profitability tends to be good, partly because SMEs typically remain loyal to their main bank, unlike large firms, which may have several banking relationships and also have access to capital markets. Banks price for risk; although SMEs sometimes find the cost high, many can make very high returns on new investments, particularly in emerging countries, so the cost is manageable.

Note that limited access to credit can also work to a company's advantage in a major downturn. Often companies that run into trouble are precisely those that have borrowed too much and tried to grow too fast, leaving themselves exposed when business turns down. But it is also vitally important that new companies find access to credit, given the inevitable failure of many existing businesses each year. Finding the right balance is the task of both companies and their lenders.

In Asia, the top five SME markets for banks by size are Japan, China, Australia, Korea and India, according to a McKinsey study (Table 2). But in terms of growth, the top five are China, Indonesia, India, Australia and Hong Kong.

Table 2: SME banking revenues

	2007 USDbn	Forecast growth
Japan	46	1
China	36	13
Australia	12	7
Korea	6.6	-6
India	6	12
Hong Kong	5.8	5
Taiwan	2.8	5
Indonesia	2.3	13
Thailand	1.4	0
Singapore	0.7	4

McKinsey data and forecasts. Source: Understanding the SME Landscape - Opportunities for Indian Banks, McKinsey study.



SMEs in Asia

Despite a tough period, Asian SMEs faced a less severe environment this time than in 1997-08, and less of a credit crunch than in the US

SMEs and the crisis

SME financing is often very vulnerable in a recession. Because banks have limited information about the ability of individual small firms to survive an economic shock, they are prone to severely limit financing to all. When there is a general credit crunch as well, the problem may be exacerbated. During the 1997-08 Asia crisis, SMEs faced major problems, though overall SMEs seem to have fared better than large firms.

In the latest crisis, Asian SMEs were helped by three factors. One was that Asian banks were mostly in good shape, unlike many banks in the US and Europe, and therefore faced less need to take drastic measures. Second, recognising the potential problem, governments put in place special guarantee measures to help maintain adequate finance for SMEs. As well as supporting SMEs directly, these programmes helped to keep banks focused on the business opportunity in SMEs rather than drawing back. Third, unlike in the US, collateral values, particularly for real estate, did not drastically fall.

Nevertheless, exporting companies faced problems because of the size of the export collapse. When US companies tried to reduce excess inventory in late 2008, they cut orders dramatically, often leaving supplier companies facing a 50% or more drop in activity. Orders have since bounced back, equally dramatically, but not all companies survived the rollercoaster intact. While there are concerns about the pace of the world economic recovery ahead, such a severe rollercoaster ride is unlikely to be repeated soon, since inventory levels in the US still appear moderate.



SMEs in Asia

Conclusion

Over the last decade, recognition of the importance of SMEs has stepped up dramatically, with important new research and increased government focus. For governments, understanding of how best to promote SMEs and avoid impeding them has increased significantly. For banks, new technologies and approaches have improved their ability to service SMEs, while providing a profitable business opportunity. The economic volatility of the last two years has been a severe test for many SMEs, particularly those focused on exporting. But many have emerged stronger, reflecting their adaptability and resilience.

Data on SMEs

Definitions vary, but SMEs are commonly defined as enterprises employing up to 250 people

For most countries, official data on SMEs is provided by periodic surveys and is published with a considerable lag. The most common definition is any firm employing up to 250 people. But some countries exclude micro and/or very small businesses (e.g., up to 5 or 10 employees), while at the upper end some countries include businesses only up to 100 employees, others up to 500. Finally, some definitions are based on turnover or capital, while some use different cut-offs for manufacturing versus service businesses.

A further difficulty with the data, particularly for less developed countries, is that there is typically a large informal sector, with businesses often employing several or even many people but not registered officially. As economies develop, this sector dwindles and businesses increasingly register and join the formal sector. The high turnover in businesses, especially at the lower end, (typically 5-20% pa) together with the opacity of accounts in some countries, means that their importance in the economy is likely understated.

Allowing for these data variations, there do appear to be structural differences in the role of SMEs in Asian economies. For example, SMEs play a larger structural role in Taiwan and China than they do in Indonesia or Malaysia. They also appear to be more export-oriented in China, Korea and Taiwan than in Indonesia, Malaysia and Singapore. The following is a snapshot of each country based on available data sourced by SCB economists on the ground, but readers are cautioned that direct comparisons between countries are difficult. My thanks to SCB economists Tai Hui, Nick Kwan, Kelvin Lau, Wei Li, Alvin Liew, David Mann, Tony Phoo, Anubhuti Sahay, Eric Alexander Sugandi and Eunhye Yoon.



SMEs in Asia

China's export-oriented SMEs have gone through a tumultuous period, with the collapse and then revival of export orders and major changes to labour regulations

China

SMEs number 42mn, (including self-employed individuals) accounting for 99.8% of enterprises and 75% of urban employment. Their contribution to the economy is immense at 60% of GDP, 68% of export volume and 50% of tax income. They also account for 66% of patent applications and 82% of new products. But they account for only 16% of bank loans.

In recent years, in addition to the effect of the abrupt slowdown in the winter of 2008-09, businesses have faced challenges from new labour regulations and new environmental regulations, among others. Also, the appreciation of the Chinese renminbi (RMB) pressured profit margins for many export-oriented businesses. Even in 2008, before the worst stage of the global crisis was reached, China's SME sector was already under severe pressure. According to one official estimate, 7.5% of SMEs had already gone out of business by end-2008.

The world downturn affected China's exporting engine as the US and European inventory correction worked through the global production chain, with exports down 26% y/y at the worst point in May 2009. The government provided extra support during the crisis by easing credit, encouraging banks to maintain loans to SMEs and directly injecting cash.

The recovery over the last 15 months, with export growth peaking at 48% y/y to May 2010, has finally pushed exports higher than Spring 2008 levels but, following the rebound, growth from here is likely to slow. Rising wage costs put pressure on businesses with very high labour intensity, and it is not so easy for smaller enterprises to move west or relocate to cheaper wage countries.

China's rapid economic growth provides huge opportunities for small businesses but tough competition; the frequent uncertainty around property rights and official rules and regulations also poses major challenges.

According to a recent OECD study, China's SMEs face all of the usual issues of limited access to finance as in other countries, together with additional obstacles arising from the transition from a planned to a market economy (OECD 2010). These include legal ambiguities concerning property rights, collateral and bankruptcy; the tighter credit standards adopted by local banks as part of financial reforms; and the withdrawal of state support for privatised enterprises. The issue of collateral is particularly interesting. One study found that, owing to difficulties with the legal situation, only 4% of bank loans in China were collateralised versus 70% in the US, though this issue does not affect only the SME sector (Han 2007).

A large informal lending sector exists, but the government recognises the importance of developing and strengthening the formal sector. The difficulty has often been how to promote this, while strengthening the credit standards of banks.

A study by the Asian Development Bank in 2007 found that overall guarantees for SMEs are underdeveloped in China, with less than 1% of SMEs receiving guaranteed loans versus nearly 20% in Korea and Taiwan and nearly 40% in Japan (ADB 2007).



SMEs in Asia

The importance of SMEs is understated as Hong Kong sets a low cut-off point, defining SMEs as no more than 100 employees

The government is very focused on the issue, recognising the key importance of SMEs for growth. There have been a series of initiatives in recent years, and new measures to help were announced on the PBOC website on 1 July 2010, including encouraging firms to borrow against moveable estate, intellectual property rights, equity and export rebates. More broadly, the authorities also aim to expand the stock and bond markets further and allow more banks to set up leasing companies, easing the flow of finance.

Hong Kong

At end-April 2010, Hong Kong reported just over 285,000 SMEs, accounting for more than 98% of businesses and more than 1.2mn jobs (48% of private-sector employment). Reflecting Hong Kong's trading role, businesses in import/export trade and wholesale accounted for 38% of the total, with retail businesses coming in a distant second and professional and business services third. Compared with other countries, Hong Kong understates the role of SMEs, or at least medium-sized businesses, since it sets the cut-off at 100 employees for manufacturing businesses and 50 employees for non-manufacturing businesses, lower than in other countries.

In December 2008 the government introduced a Special Loan Guarantee Scheme (SpGS) to tackle the credit crunch arising from the global crisis. The government announced in April 2010 that the application period would be extended for another six months until 31 December 2010, for the last time. The standard SME Loan Guarantee Scheme (SGS) will continue to render assistance to SMEs.

As at the end of April 2010, some 18,200 companies benefited under these (special and extended) schemes, involving an approved loan amount totalling HKD 83bn (and over 30,000 applications). This also indirectly helped to secure the jobs of those employed by these companies, totalling over 300,000.

In November 2008, the Census and Statistic department instituted a survey of SMEs on credit availability. By April 2010 the proportion of SMEs reporting credit hard to get was down to 4%, compared with 12% in December 2008. The UPS ABM survey, reported 19 August 2010, found that 60% of SMEs reported no difficulties in financing their business, a marked improvement on the 33% a year earlier (ABM Hong Kong).

Hong Kong's recovery from the crisis has seen SMEs bouncing back well overall from the crisis. Business receipts for SMEs in import/export trades regained most of the lost ground over the past year, in tandem with the strong revival of trade flows within the region. The business situation in financing institutions also improved further. However, business receipts in the logistics sector were still notably down from the normal level.

The business situation in the local segments attained across-the-board improvement in recent months, with SMEs in the insurance sector showing the fastest recovery. Travel agents and retail trade saw a rebound in business receipts, as did restaurants, thanks to the firmer consumer sentiment over the period. However, the improvement in business receipts of real estate stalled in recent months after the earlier rebound, following the government's recently announced measures to forestall the risk of a property market bubble. The UPS ABM survey found that 20% of firms expect to increase their work forces over the next year, versus only 6% a year earlier.



SMEs in Asia

Table 3: Distribution of SMEs (as of March 2010)

		No. of businesses in SMEs	No. of persons engaged by SMEs
Total		285,188	1,210,287
Industry	Manufacturing	11,974	74,614
	Mining & quarrying; electricity, gas & waste management; and Construction	1,048	12,924
Services	Import/export trade and wholesale	110,169	452,177
	Retail	43,619	141,718
	Transportation, storage, postal and courier services	8,128	45,100
	Accommodation and food services	11,046	102,955
	Information and communications	9,026	37,211
	Financing and insurance	15,865	54,624
	Real estate	10,629	30,841
	Professional and business services	33,433	128,879
	Social and personal services	30,251	129,244

All figures are compiled based on the Hong Kong Standard Industrial Classification (HSIC) Version 2.0.
For detailed notes on the data see Source: Census and Statistics Department

India has large numbers of micro businesses and informal enterprises, but the importance of the formal SME sector is growing fast

India

Estimates suggest the micro, small and medium-sized enterprises (MSME) sector accounts for about 45% of manufacturing output and 40% of total exports. The sector employs about 42mn people in over 13mn enterprises. Moreover, it has been growing at a faster rate than the economy as a whole.

India's population continues to be largely rural – more than 70% of people live in rural areas – which tips the numbers a little compared with other countries, but still leaves SMEs playing a very important role. India also has an enormous number of micro-enterprises, often engaging just one person, in every sector including manufacturing. While micro-finance is a crucial and now very important part of successful development, it is very different from SME finance.

The government has increasingly focused attention on strengthening the SME sector with the enactment of the Micro, Small and Medium Enterprises Development (MSMED) Act in 2006, an important step forward.

Micro enterprises are also very important in Indonesia; large enterprises still dominate exports

Indonesia

SMEs contribute about 55% to GDP, including medium-sized enterprises at about 13%. They are overwhelmingly important for employment if micro-enterprises are included, at 97%. However, excluding micro-enterprises, they account for about 8% of employment, compared with large companies' contribution of about 3%. Large companies overwhelmingly dominate exports, at 83%, but medium-sized companies are of growing importance at 11% while small companies contribute 4%.

SMEs in Korea have been vital for job creation, as the industrial structure continues to shift the balance away from large enterprises

Korea

SMEs account for 99.9% of enterprises and 87.7% of employment. In the last 10 years, they have added 3.79mn jobs while large companies have shed 0.63mn. Data show the manufacturing sector accounts for about 49% of added value, a share that has risen from 26% in the 1960s, but seems to have stabilised at about half in the last couple of decades. SMEs directly contribute about 32% to exports.



SMEs in Asia

SMEs play a key role, though perhaps less than in some other countries; the government is focusing on moving them up the value chain

The Korean government works hard to foster innovative businesses by designating companies with technological competitiveness and growth potential as innovative businesses. As of 2009 it identified 39,000 such businesses, including 15,900 classified as technologically innovative and 14,000 as managerially innovative (companies can be both). The numbers are growing fast.

Malaysia

SMEs account for 99% of businesses by number, 56% of employment, 32% of GDP and 19% of exports. As such, they play a key role in the economy albeit lower than in some other Asian economies (though note that the cut-off is set at 150 employees, compared with 250 in some countries). In manufacturing, 96% of establishments were SMEs, contributing 31% of total manufacturing output and 26% of value added. More than 400,000 people or 32% of the total workforce was employed in this sector. The bulk of SMEs, about 86%, are in the service sector.

The government is very supportive of SME growth and development, through various initiatives implemented via the various Malaysia Plans and Industrial Masterplans, as well as the establishment of the National SME Development Council (NSDC). The emphasis is on helping SMEs move up the value chain. During the economic crisis, the government stepped up its help for SMEs, with measures amounting to about 2% of GDP (SMEECorp 2009).

Singapore

SMEs account for 99% of businesses, 60% of employment and 49% of value-added. As elsewhere, wholesale and retail trade account for the largest number, at 32%, with real estate and business services next at 19%. Manufacturing, although only 5% by numbers, comprises 17% of value added. The government provides several useful assistance programmes, including the SME Management Action for Results Initiative (SMART) and Startup Enterprise Development Scheme (SEEDS).

The UPS Asia Business Monitor (ABM) report for Singapore (released August 2010) found a marked improvement in optimism, with signs that business is returning to normal after the shocks of 2008-09. A total of 49% of respondents expect better business prospects this year, up from only 14% in the 2009 survey. An overwhelming 73% of these SMEs said they see most opportunities for trade growth within the Asia-Pacific region (12% in 2009), followed by the Middle East at 40% (22% in 2009). The three critical challenges cited most commonly in the survey are high operating costs, (53%), competition (30%) and skill shortages (28%). In 2009, the top concern was the business downturn.

The UPS survey includes a competitiveness index and finds Singapore SMEs number one in competitiveness among 13 markets, ahead of Hong Kong and Australia. This competitive advantage derives from the highest levels of access to funding and working capital in Asia, coupled with strongly developed supply chain efficiency, government support, legal framework, transportation and infrastructure, high IT adoption and easy access to overseas markets. The survey is conducted by global market research firm TNS (ABM 2010).



SMEs in Asia

SMEs remain hugely important, though the changing structure of Taiwan's industry is reducing its direct export share

Taiwan

In 2008, there were 1,235,000 SMEs, accounting for 97.7% of total enterprises and employing 8mn people. The latest comprehensive data on value added, from the 2006 5-year census, suggests SMEs account for 42% of the gross production value of enterprises, down slightly from a high of 47% in 1996. About 80% of SMEs are in the service sector, with 52% of all SMEs in wholesale and retailing. About 35% are owned by women. In Taiwan the official definition of an SME is an enterprise with fewer than 200 employees in manufacturing, construction and mining, and fewer than 100 employees in other sectors.

Taiwan's early economic development was famous for the key role of small and medium-sized firms, though many have grown large. The share of exports accounted for by SMEs has been falling, from 26.4% in 1997 to 17.4% in 2008. This reflects the change in the structure of Taiwan's industry, which has shifted the focus of export trade to large enterprises. Taiwan is a good example of SMEs undertaking specialised production of materials and components, which are then assembled or processed further by a large enterprise who then exports them.

The data show that turnover of SMEs is fairly high. In 2008, 7% of SMEs had been in existence for less than 1 year and 34% for less than 5999 years. Still, 45% of SMEs have been in business for over 10 years and more than 20% for over 20 years. The government is focused on providing support through a variety of channels.



SMEs in Asia

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