SMEs and Global Markets: The Missing Link for Inclusive Growth

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SMEs: different definitions, different weights in the economy

- There is no universally accepted definition of Small and Medium Sized Enterprise.
- In most countries SMEs represent:
  - Above 90 per cent of the number of firms
  - Around 60 per cent of employment
- ... but the picture differs across countries

<table>
<thead>
<tr>
<th>Country by pc-GNI</th>
<th>Max # employees</th>
<th>Country by SME size</th>
<th>Max # employees</th>
</tr>
</thead>
<tbody>
<tr>
<td>Norway</td>
<td>100</td>
<td>Pakistan</td>
<td>50</td>
</tr>
<tr>
<td>Switzerland</td>
<td>250</td>
<td>Vietnam</td>
<td>300</td>
</tr>
<tr>
<td>Brazil</td>
<td>100</td>
<td>Bangladesh</td>
<td>100</td>
</tr>
<tr>
<td>Thailand</td>
<td>200</td>
<td>Ghana</td>
<td>100</td>
</tr>
<tr>
<td>Moldova</td>
<td>250</td>
<td>Tanzania</td>
<td>20</td>
</tr>
<tr>
<td>Egypt</td>
<td>50</td>
<td>Malawi</td>
<td>50</td>
</tr>
</tbody>
</table>

Percentage

- United Arab Emirates
- Bahrain
- Oman
- Saudi Arabia

Legend: Micro, Small, Medium
SME Competitiveness Outlook 2015

Benefits from background studies:

- Dorothy McCormick and Herbert Wamalwa, University of Nairobi
- Charles Harvie, University of Wollongong
- Gerald McDermott (University of South Carolina) and Carlo Pietrobelli (IDB and University Roma Tre)
- Lei Zhang and co-authors, Shanghai University of International Business and Economics (SUIBE)
- Leila Baghdadi, Tunis Business School
- Ashraf Ali Mahate, Handam bin Mohammed Smart University, Dubai and Dubai Exports.
- Jaroslav Zhalilo, Institute for Economics and Forecasting, Kiev
SME Competitiveness Outlook 2015:
SMEs and Global Markets – The Missing Link for Inclusive Growth

SMEs: Who are they and how do they perform in global markets?

Key bottlenecks to SME internationalization …

Bottlenecks, So What? … Key arguments for assisting SMEs

The small push that may make the difference for SME growth

Internationalizing? Ok, but the elegant way

Local SMEs and Global Policies
SMEs: who are they and how to the perform in global markets?
In LDCs, firms are born small and tend to stay small

Source: OCE calculations from World Bank ES dataset

Developed countries in sample are predominantly eastern European nations
Theory predicts it, data confirm it: exporters tend to be larger in size than non-exporters

Source: OCE calculations from World Bank ES dataset

*Exporter* is defined as a firm with 10% or more of sales exported (direct plus indirect)
Strengthening SMEs

A Quick Win in Terms of Growth?
SME Characteristics: Productivity and wages

- SMEs are generally less productive than large firms
- The gap is larger in developing economies

Relative Productivity & Wage Gaps in Selected South American and OECD Countries (Large firms=100)

Source: Adapted OECD-ECLAC, 2013, p. 47
SME Characteristics: Productivity and wages

- SMEs are generally less productive than large firms
- The gap is larger in developing economies
- A similar pattern is observed with wages
- Working with SMEs will be a challenge, but there are large gains to be made

From McDermott and Pietrobelli, ITC, forthcoming

Relative Productivity & Wage Gaps in Selected South American and OECD Countries (Large firms=100)

Source: Adapted OECD-ECLAC, 2013, p. 47
Internationalizing the elegant way
Exports Matter for SME Productivity and so do Imports
Firms engaging in trade are more productive than firms not engaging in trade (no exports, no imports), with the exception of offshore firms that do not import.
Internationalizing the elegant way

Linking up to Value Chains … but how?
Linking up to value chains … but how?

Gains at the bottom of the chain are not necessarily high

<table>
<thead>
<tr>
<th>Company</th>
<th>Function</th>
<th>Cumulating</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chinese Farmers</td>
<td>Raw material</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td></td>
<td>1</td>
</tr>
<tr>
<td>Chinese Factory</td>
<td>Manufacturing costs</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td></td>
<td>3</td>
</tr>
<tr>
<td>Chinese Factory Owner</td>
<td>Owner margin</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td></td>
<td>5</td>
</tr>
<tr>
<td>Lebanese design workshop</td>
<td>Design</td>
<td>0.1</td>
</tr>
<tr>
<td></td>
<td></td>
<td>5.1</td>
</tr>
<tr>
<td>Boat</td>
<td></td>
<td>0.2</td>
</tr>
<tr>
<td></td>
<td></td>
<td>5.3</td>
</tr>
<tr>
<td>Customs</td>
<td></td>
<td>0.7</td>
</tr>
<tr>
<td></td>
<td></td>
<td>6</td>
</tr>
<tr>
<td>Chinese state plant</td>
<td>Quotas</td>
<td>0 – 0.5</td>
</tr>
<tr>
<td>Spanish trader</td>
<td>Trader margin</td>
<td>2</td>
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<tr>
<td></td>
<td></td>
<td>8</td>
</tr>
<tr>
<td>Spanish supermarket</td>
<td>Distribution</td>
<td>20</td>
</tr>
<tr>
<td></td>
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<td>28</td>
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<tr>
<td>Lebanese company</td>
<td>Market research</td>
<td>10</td>
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<td></td>
<td></td>
<td>38</td>
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<tr>
<td>Lebanese company</td>
<td>Advertising</td>
<td>2</td>
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<tr>
<td></td>
<td></td>
<td>40</td>
</tr>
<tr>
<td>French Brand</td>
<td>Margin</td>
<td>10</td>
</tr>
<tr>
<td></td>
<td></td>
<td>50</td>
</tr>
</tbody>
</table>

Harvie et al (2010) show that moving up the value chain (in 7 Asean country and China) is notably facilitated by:

- Higher labour productivity
- Higher foreign ownership share
- ICT as core business
- Having acquired production knowledge

Initial level of **supplier capacity** will determine:

- the governance approach within the chain
- and will determine gains captured by suppliers
# SME Competitiveness Grid

## 3 Pillars of Competitiveness

<table>
<thead>
<tr>
<th>Internal factors: strengths and weaknesses</th>
<th>SME Readiness to Trade</th>
<th>Capacity to Connect</th>
<th>Capacity to Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>3 Layers of Determinants</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>External factors: opportunities and threats</td>
<td>Immediate business environment</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Overall economy</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
3 Pillars of SME Competitiveness

- **Compete** Now:
  - Delivered in time
  - Meet quality requirements
  - Meet cost requirements

- **Connect**:
  - Know your customer and reach out
  - Know your competitor
  - Know what is changing in markets

- **Change**:
  - Have access to funding
  - Have access to skills
  - Be able to innovate
Pillars of competitiveness

The most important
Bottlenecks to SME internationalisation

Access to information about procedures
and regulations for exports or import 15%
Access to trade finance 16%
Access to information about export opportunities 23%

Based on an ITC survey of 418 SMEs. Top three responses

The percentage of SMEs with

- website
- email account
- production certified to an international standard

LDC Slovenia: 20% website, 85% in total
LDC Barbados: 43% email account, 100% in total
LDC China: 13% production certified, 52% in total

LDC compared to the best performing country.
Based on World Bank Enterprise Survey data.
3 Layers of Determinants of Competitiveness

- **SME Readiness to Trade** (firm level capacity), e.g.:
  - Quality control system in place
  - Search for market information
  - Have a business plan

- **Immediate business environment**, e.g.:
  - Access to quality certification institution
  - Linkages to relevant players (e.g. cluster)
  - Access to institutions/mechanisms lending to SMEs

- **Overall economy** (business environment at the “macro”-level), e.g.:
  - Border procedures
  - Internet bandwidth
  - Efficiency of banking sector (interest rate spread)
The ‘immediate’ business environment matters

**Coordination**: McCormick and Wamalwa cite examples of African countries where, multiplicity of ministries and departments handling SME issues leads and lack of strong sector specific associations at the local level has contributed to co-ordination failures.

**Knowledge and technology spillovers**: McDermott and Pietrobelli refer to the key benefit from inter-firm linkages, be they horizontal or vertical, in terms of knowledge and technological spillovers and externalities among the firms.

Citing evidence of the Wenzhou clusters in China, Zhang et al. (forthcoming) argue that clusters play an important role in the internationalization of SMEs, because:

- **transaction and information gathering costs** are reduced
- Firms in the cluster share a regional brand
- The cluster facilitates integration into global value chains, often directly through the establishment of multinational joint ventures
Summing Up

- SMEs represent significant share of economic in terms of GDP and employment
- Significant economic gains can be obtained from raising productivity in SMEs as distance to productivity frontier is often large in developing countries
- Higher productivity is likely to higher wages
- Increasing SME productivity can significantly contribute to inclusive growth
Summing Up

Increasing SME productivity can significantly contribute to inclusive growth

Exporters are more productive
Importers are more productive

How to get there?

Increase competitiveness to:

- Link up directly to global markets
- Or indirectly through value chains, but the elegant way

3 Layers of Determinants of SME Competitiveness:

- SME Readiness to Trade (firm level capacity)
- Immediate business environment
- The overall economy

3 Pillars of SME Competitiveness:

- Compete
- Connect
- Change