

ASIA'S GROWTH, PRODUCTION NETWORKS, AND SMES



The escalating Eurozone crisis and signs of spluttering world growth have put Asia and its manufacturing enterprises into the spotlight again. Part of Asia's rapid trade-led growth over several decades is associated with production networks and a regional division of labor. An expanding literature suggests that the region's trade is increasingly made up of growing intraregional trade in intermediate inputs (Athukorala 2011). Production activities are increasingly being geographically fragmented across countries and linked by a dense network of trade in intermediate goods (Baldwin 2008).

Small- and medium-sized enterprises (SMEs) are viewed as the backbone of national economic development in many Asian economies, accounting for the majority of firms and a large share of employment (Harvie 2010).

It is possible that more engagement of SMEs in production networks through supply chain links with MNCs can contribute to Asia's growth in uncertain economic times. Potential benefits may include lower trade costs, improved efficiency, job creation and inclusiveness, and rebalancing towards domestic and regional demand (Lim and Kimura 2010). Little is known, however, on whether SMEs are active players in Asia's production networks and the various influences on their engagement.

SMEs' role in production networks

Empirical research on SMEs in production networks in Asia has been hitherto constrained by an absence of comparable published data at industry-level. To overcome this limitation, in a recent study I use micro-level data from 5,900 manufacturing enterprises from five ASEAN economies – Malaysia, Thailand, Indonesia, the Philippines, and Vietnam – at different levels of economic development (Wignaraja 2012). The randomly selected enterprise-level data come from the World Bank's Enterprise Surveys and are for 2006 or 2008. SMEs are defined in the study as enterprises having less than 100 employees. The study focusses on three issues concerning ASEAN SMEs:

1. How much do SMEs engage in production networks?
2. What factors influence SME participation in production networks? And

3. What implications can be drawn for SME support?.

Several findings from the study are noteworthy. First, although large firms are the leading players, there is a reasonable base of SMEs in production networks in ASEAN economies. About 22% of SMEs as a share of all SMEs in the sample participate in such networks (as direct exporters or suppliers to MNCs).

Meanwhile, 72.1% of all large firms in the sample engage in production networks.

Second, higher SME participation rates are visible in more industrially developed ASEAN economies (e.g. Malaysia and Thailand) with more inward investment and exposure to production networks than other ASEAN economies. As much as 46.2% of all Malaysian SMEs and 30% of Thai SMEs engage in production networks. These figures compare with lower SME participation rates in other ASEAN economies like 21.4% for Vietnam, 20.1% in the Philippines, and 6.3% in Indonesia.

Third, SMEs are involved in exporting directly to international markets but less than large firms in the five ASEAN economies. SMEs account for 23% of direct exports from all ASEAN sample firms compared with 77% for large firms.

Malaysia (28.1%) and Thailand (34.7%) are ASEAN's leaders in terms of SME shares of direct exports. Vietnam has an SME export share of 16.8% while Indonesia has 9.3%.

Fourth, econometric analysis underscored the notion of firm heterogeneity in production networks in ASEAN economies (i.e. that firms are considered different in terms of efficiency and fixed and variable costs when involved in production networks). The probability of SME participation in production networks was positively and significantly affected by various factors including larger firm size, more foreign ownership, highly educated workers, experienced chief executives, higher technological capabilities, and ready access to commercial bank credit.

Fifth, the exploration of policy influences on SME business activity in ASEAN economies provides additional insights. A trust deficit seems to hamper the requisite intra-firm cooperation needed for effective SME participation in production networks. Supply-side factors – like lack of access to finance, high electricity costs, variable quality of transport systems, and inadequately educated workers – are an additional hindrance to SMEs. On the policy and incentive side, behind-the-border issues like high corporate tax rates as well as economic uncertainty also play their part. Finally, the limited evidence from Malaysia and Thailand suggests that the affordability and quality of business support services are an issue.

Policy implications

Evidence of the participation of SMEs in production networks, particularly in more developed ASEAN economies, is encouraging and can lay the foundation for future SME growth. Nonetheless, it also seems that SMEs in ASEAN economies are at a disadvantage in participation in production networks compared with large firms. SMEs face, to a larger extent than large firms, resource constraints (in terms of finance, information, management capacity, and technological capability).

Moreover, SMEs suffer disproportionately from external barriers like market imperfections and regulations. The push for more inclusive Asian growth, coupled with the disadvantages of small firm size, justifies greater public policy support for involving SME in production networks in ASEAN. In the main, such support should be geared to ensuring an environment that opens access to markets, reduces bureaucratic impediments against SMEs, and provides appropriate SME institutional support services (e.g. technological, marketing, and financial support).

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