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Mainstreaming SMEs: Promoting Inclusive Growth in APEC

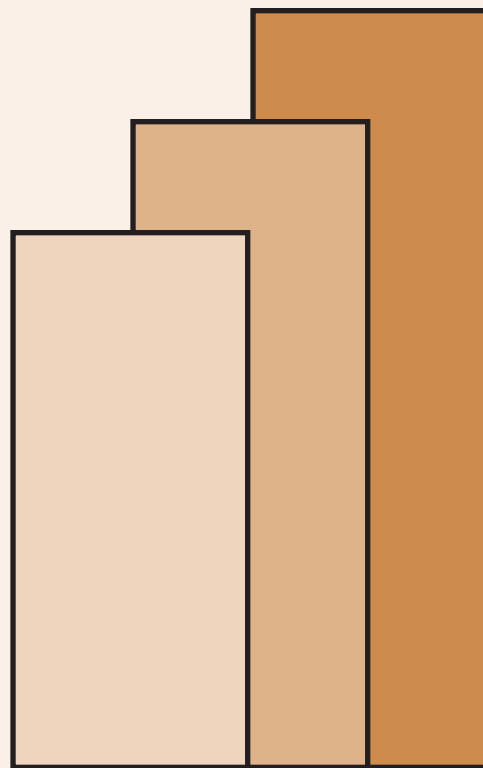
Erlinda M. Medalla and Melalyn C. Mantaring

DISCUSSION PAPER SERIES NO. 2017-48

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December 2017

For comments, suggestions or further inquiries please contact:

The **Research Information Department**, Philippine Institute for Development Studies
18th Floor, Three Cyberpod Centris – North Tower, EDSA corner Quezon Avenue, 1100 Quezon City, Philippines
Tel Nos: (63-2) 3721291 and 3721292; E-mail: publications@mail.pids.gov.ph

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Erlinda M. Medalla and Melalyn C. Mantaring



Philippine Institute for Development Studies

List of Acronyms

A2F	-	Access to Finance
A2M	-	Access to Markets
ABAC	-	APEC Business Advisory Council
APEC	-	Asia-Pacific Economic Cooperation
APFF	-	Asia-Pacific Financial Forum
ASEAN	-	Association of Southeast Asian Nations
BE	-	Business Environment
BSMED	-	Bureau of Small and Medium Enterprise Development
CHEP	-	Committee on Host Economy Priorities
CO	-	Certificate of Origin
DA	-	Department of Agriculture
DOLE	-	Department of Labor and Employment
DOST	-	Department of Science and Technology
DOT	-	Department of Tourism
DTI	-	Department of Trade and Industry
FDI	-	foreign direct investment
FTAs	-	free trade agreements
GDP	-	gross domestic product
GVCs	-	global value chains
IFRS	-	International Financial Reporting Standards
IT	-	information technology
MSMEs	-	Micro Small and Medium Enterprises
MSMED	-	Micro Small and Medium Enterprise Development Plan
NEDA	-	National Economic and Development Authority
P&E	-	Productivity and Efficiency
PN	-	production networks
SMEs	-	small and medium enterprises
SMED	-	Small and Medium Enterprise Development Council
UNCTAD	-	United Nations Conference on Trade and Development

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Erlinda M. Medalla and Melalyn C. Mantaring¹

Abstract

SME development as a major domestic policy objective that is consistent and reinforced within APEC would not only engender inclusive growth, but also enable SMEs to become drivers of growth for the domestic, as well as the regional economy. This paper provides some background about the setting, locally in SME development policy and regionally in APEC SME activities, and offers recommendations for APEC cooperation for mainstreaming SMEs in the regional and global market.

1. Introduction

Small and Medium Enterprises (SMEs) account for more than 97 percent of enterprises and more than half of employment in APEC economies, developed and developing alike.² Thus, addressing SME concerns addresses a huge part of any country's economic and social objectives. In particular, SMEs play a huge role in poverty reduction, being a major source of employment for poor and low-income workers, and for poorer regions within economies. At the same time, SMEs could play a critical role for economic growth. SMEs contribute in creating a stable economy arising from their flexibility and capacity to easily absorb labor (skilled and unskilled). In addition, the viability of SMEs is essential for creating competitive and efficient markets. As such, a vibrant SME sector is also a potential, dynamic source of growth and innovation.

This glosses over the fact that SMEs differ across countries, across sectors/industries within countries, and within sectors/industries. The 97 percent of enterprises comprising SMEs are widely heterogeneous. They are in different sectors, in different locations, and with varying education, efficiency, capital intensity, and innovation status. This makes it extremely difficult to come up with overall policies and programs for SME development. Economic theory suggests that the key is to target productivity and competitiveness. Indeed, the basic foundation of industrial development policy, regardless of firm size, is enhancing productivity. Nonetheless, there are inherent barriers and constraints to being small, notably with regards to access to finance, markets and technology.³ Unlocking these constraints would engender an inclusive growth for any country.

¹ Senior Research Fellow and Project Development Officer IV of the Philippine Institute for Development Studies (PIDS), respectively. The authors would like to acknowledge the research assistance provided by Angelica Maddawin and Susan Pizarro in preparing this paper. The usual disclaimer applies.

² APEC Policy Support Unit, Policy Brief No. 8, SMEs in the APEC Region, December 2013.

³ See related discussion in later sections of the paper.

In addition, economies, in its pursuit of SME development as a major domestic policy objective, could not ignore the global and regional environment. The objective is not to keep enterprises small. The ultimate objective is to provide SMEs access and the opportunities and means to grow, and to encourage those SMEs with potential to eventually become major players, whether in the domestic or the international market. As such, SME development policy should not be confined within the context of limited local environment. A more global perspective has become increasingly important with the “integration of trade” and “de-integration of production” arising from globalization forces and technological development.

At the same time, regional economic integration that would promote economic growth while ensuring that all sectors benefit could not be achieved without an effective strategy for SME participation in the regional/global integration. Fostering SME participation in the international market has thus been a major APEC objective. This is manifested in the APEC structure and evidenced by the amount of work done related to SME in its various committees. This focus is reiterated and reinforced when the Committee on APEC 2015 Host Economy Priorities (CHEP) identified SMEs as one of the major priorities in the substantive agenda during the Philippines APEC hosting in 2015.

This paper aims to serve as a background on fostering SME participation in the international market as a Philippine APEC priority area, and to explore recommendations for mainstreaming SMEs in the global market. The paper starts with a brief background on the Philippine SME policy environment. This provides the context for advancing SME participation in APEC. This is followed by a presentation of some evidence on SME participation in the international market. Then, the next section looks at the APEC initiatives in promoting SME participation in the international market. The last section provides the conclusion and recommendations.

2. Background and Context ⁴

Rising globalization accompanied by increasing regional integration and growth of global value chains (GVCs) has opened opportunities for SMEs. These arise from the resulting product fragmentation and increased specialization in specific tasks and activities that are more suited to SMEs. At the same time, these developments that have drastically changed the character of global trade and the business environment introduce new challenges and risks to SMEs as well. Unfortunately, some SMEs would be more able than others to deal with the new challenges and opportunities, and along the same vein, some countries have been more successful than others in promoting their SMEs. A major factor is the different levels of development across APEC economies. SMEs in developed countries, like Japan and the United States (and industrialized countries in general) work with more capital and are generally better connected and equipped. Another factor is the longer history of being part of Free Trade Agreements (FTAs) for some countries, e. g. Thailand. Nonetheless,

⁴ Some discussions were drawn from Medalla et al (2015) Preliminary assessment of the ‘Shared Service Facilities (SSF)’

SMEs are of great concern to all APEC economies, especially with the rising anti-globalization sentiments as some sectors are left behind. Governments need to understand better how to maximize the participation of SMEs, locally and internationally, and how regional cooperation and integration could be made to produce a more inclusive growth. Indeed, many governments have intensified their efforts in defining policies and programs to support SMEs in the new environment.

The Philippines, like many developing countries, has been struggling to find better solutions and more effective approaches to SME development. Many studies have looked into surrounding issues, from access to finance, technology, innovation, and differences among firms to come up with strategies and recommendations (See, for example, Aldaba, 2008, 2013; Wignaraja, 2012).

In the Philippines, there are two operational definitions⁵ for classifying SMEs: one is employment-based and the other is asset-based. Small enterprises are comprised of establishments with 10-99 employees, and/or P1.5-15 million in assets, while medium enterprises are establishments with 100-199 employees, and/or P15-60 million in assets. In addition, there is a special classification by size for Micro establishments (ME) with 1-9 employment size and up to P3 million asset size (as per official NSO definition), which is what Philippine establishments predominantly are.

MSMEs (Micro, Small and Medium Enterprises) dominated the domestic economy in number and constitute a huge bulk of manufacturing enterprises. The share of MSMEs have been almost constant at around 99.6% of total from 2008 to 2014. Of this, in 2014, 89.9% are micro enterprises, down from 91.6% in 2008. Only 8.6 % are small establishments in 2008, which rose to 9.2% in 2014. A miniscule 0.4% are medium-sized establishments. MSMEs employ more than 61% of the workforce in 2008, peaking at 65% in 2012 before declining to around 63% in 2014. See **Table 1**.

Data for the distribution of value added (and exports) according to firm size have not been updated, but based on BSMED-DTI (Bureau of Small and Medium Enterprise Development, Department of Trade and Industry) calculation (using 2006 data), MSMEs contribute 16-31% of total exports and 36% of the total gross value added.

Aldaba (2008, 2013), summarizes and groups barriers to SME development into internal and external factors. Internal factors include lack of access to technology, skills and finance. Most SMEs face various challenges in the areas of finance, human resource development and access to technology and business support infrastructure. Generally, they have difficulty accessing formal credit. Banks are reluctant to lend because they regard SMEs as high-risk borrowers since most SMEs have no business plans, lack assets that can be used as collateral and have practically no financial records or accounting system. SMEs

⁵ Based on the National Statistics Office (NSO) and Small and Medium Enterprise Development Council Resolution No. 1 Series 2

underinvest in R&D, innovation, new technologies or capital equipment, as well as in technical skills and training that would make them productive and competitive.⁶

Table 1. Distribution by Establishment and Employment, various years

	<i>% share</i>			
	2008	2011	2012	2014
Establishments	100	100	100	100
Large	0.4	0.4	0.4	0.4
<u>MSMEs</u>	99.6	99.6	99.5	99.6
Medium	0.4	0.4	0.4	0.4
Small	7.7	8.6	9.7	9.2
Micro	91.6	90.6	89.4	89.9
Employment	100.0	100.0	100.0	100.0
Large	38.8	39.0	35.0	37.2
<u>MSMEs</u>	61.2	61.0	65.0	62.8
Medium	7.5	7.1	7.3	6.8
Small	23.7	25.9	27.2	25.5
Micro	30.0	28.0	30.5	30.5

Source: DTI-BSMED

At the same time a host of external factors such as poor physical infrastructure and a discriminating legal framework limit the ability of SMEs to thrive. This points to the need for government support measures in opening access to markets and technology and removing policies that put a bias against SMEs. In general, the government should offer a supportive business environment addressing both these internal and external constraints hindering development.

The government has long recognized the role of SMEs in development (even as early as the 1970s) and has devoted considerable efforts in promoting SME development through a variety of programs and institutional support (Aldaba 2013). The apparent lack of progress is discouraging, considering the numerous studies and programs that have been launched on SME development. The same constraints and problems are noted in most studies.

A bigger push for SMEs has thus been initiated during the Aquino administration. Coordination failures have become more apparent as a major factor in the past. To enhance communication and coordination among key agencies in order to support SME, a National SME Agenda was crafted. There were earlier Philippine SME Development Plan but the Micro Small and Medium Enterprise Development Plan (MSMED) 2011-2016 provides

⁶ These findings and observation have also been noted by SME working groups in APEC.

the overall guidance and direction to the SME agenda. The plan “*serves as the framework for the convergence of initiatives adopted and implemented by multi-stakeholders...*” and aims to support and encourage SME growth in the country. The overall coordinating agency for SME growth and development is the Small and Medium Enterprise Development (SMED) Council, which is Chaired by Department of Trade and Industry (DTI) and composed of the Director General of the National Economic and Development Authority (NEDA), the Secretaries of Agriculture (DA), Labor and Employment (DOLE), Science and Technology (DOST) and Tourism (DOT). The Board is also composed of the Chairpersons of the Monetary Board and the Small Business Guarantee and Finance Corporation, three representatives of the private sector, and a representative from the private banking sector.

Table 2 summarizes some of these government programs. The list implies a comprehensive and integrated strategy that attempts to focus on the following critical areas: business environment, access to finance, access to markets, productivity and efficiency. It attempts to address both the internal and external factors affecting SME development. It covers promotional, capacity building and regulatory reform aspects.

Table 2. Philippine Government Policies and Programs for SMEs

Business Enabling Environment: Advocacy of SME Laws	Magna Carta for Micro, Small and Medium Enterprises (RA No. 6977 as amended by RA No. 8289 and RA No. 9501)
	Barangay Micro Business Enterprises (BMBEs) Act of 2002 (RA No. 9178)
	Go Negosyo Act (RA 10644) ⁷
Access to Finance: SME Financing Support Programs	Microfinance Program/s: <ul style="list-style-type: none"> • People’s Credit and Finance Corporation (PCFC) • Access of Small Entrepreneurs to Sound Lending Opportunities (ASENSO) Program • Rural Micro Enterprise Promotion Programme (RuMEPP)⁸ • Mandatory Allocation of Credit Resources to MSMSEs (RA 9501)-- 8% for micro & small enterprises; 2% for medium enterprises

⁷ To bring government services closer to small businesses through the establishment of Negosyo Centers in all provinces, cities, and municipalities. The Negosyo Centers shall be responsible for promoting ease of doing business and facilitating access to services for MSMEs. Aside from facilitating business registration through the Philippine Business Registry System, the Centers shall provide assistance to MSMEs in the availment of technology transfer, production and management training programs, and marketing assistance of the DTI, DOST, UPISSI, CDA, TESDA and other agencies concerned.

⁸ Aims to reduce rural poverty through increased economic development, job creation and rural incomes for poor rural households by promoting profitable & sustainable micro enterprises (MEs). While the Programme will operate in poor provinces, the micro-credit component will be implemented nationwide through the NICCEP industries.

<p>Access to Markets:</p> <p>(1) Product Development & Design Services</p> <p>(2) Export Pathways Program</p> <p>(3) Facilitating Business Partnerships</p> <p>(4) Trade Fairs & Exhibitions</p> <p>(5) Doing Business in Free Trade Areas (DBFTA)</p> <p>(6) Facilitating Business Partnerships</p>	<p>(1) Product Development & Design Services—Product designs; Technology upgrading workshops; Design & technical information; Design library; Conduct of design competition</p> <p>(2) Export Pathways Program-Regional Interactive Platform for Philippine Exports (RIPPLES)⁹</p> <p>(3) National Industry Cluster Capacity Enhancement Project (NICCEP)¹⁰</p> <p>(4) Manila F.A.M.E; IFEX Philippines; National & Regional Trade Fairs;</p> <p>(5) Seminars; Trade facilitation; Advisory/consultancy</p> <p>(6) One Town One Product (OTOP) Stores- Tindahan Pinoy; ¹¹ Buyer-Seller Matching; Domestic/Foreign Trade Facilitation;</p>
<p>Productivity and Efficiency:</p>	<p>(1) Technology Upgrading: Department of Science & Technology (DOST)---</p> <ul style="list-style-type: none"> • Small Enterprise Technology Upgrading (SET-UP)¹² • Technology Business Incubator Program <p>(2) Shared Service Facilities (SSF)¹³</p>

⁹ Focuses on providing export assistance through a systematic approach, providing interventions at every stage of an exporter’s growth. It utilizes the Value Chain Approach (VCA), Industry Clustering, and Sub-contracting to arrive at a holistic export development program that will ensure a stronger and more dynamic export industry. Such dynamism would be a tool for the regions to nurture SMEs with potential to become exporters.

¹⁰ The development and promotion of industry clusters are identified as a major strategy under the Philippine Development Plan 2011-2016 in helping achieve its vision of a globally- competitive and innovative industry and services sector that contributes significantly to inclusive growth and employment generation. Using the industry cluster approach, DTI will build alliances with relevant agencies and institutions to develop competitive and innovative SMEs, implement a program for productivity and efficiency and create conducive business enabling environment

¹¹ The project will serve as the showcase of the country’s excellent products from the traditional to the contemporary. It will serve as an alternative channel in the promotion and sale of OTOP and other SME products and services through a network of physical outlets that will be supported later on by electronic outlets.

¹² is a nationwide strategy to encourage and assist SMEs to adopt technological innovations to improve their operations and thus boost their productivity and competitiveness. The program enables firms to address their technical problems through technology transfer and technological interventions to improve productivity through better product quality, human resources development, cost minimization and waste management, and other operation related activities

¹³ refers to common service facilities or production centers that give MSMEs access to better technology and more sophisticated equipment to accelerate their bid for competitiveness help them graduate to the next level where they could tap a better and wider market and be integrated in the global supply chain

	(3) SME Roving Academy ¹⁴ (4) Technology Information for Commercialization (TECHNICOM)
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Source: Department of Trade and Industry (DTI)

Still the beleaguering question remains. With all the push and programs for SMEs, and the identification of barriers and constraints, why does SME development remain a major problem? How much has really been accomplished? These are difficult to answer because of lack of a more comprehensive data. There are anecdotal stories of both successes and failures, and some programs seem to help (see for example a preliminary assessment of SSF by Medalla et al, 2016) but it is difficult to assess what has been the overall impact on SMEs.

An underlying factor for the apparent limited success in SME development is the enormity of the tasks, with MSMEs comprising more than 99 percent of all enterprises that are too diverse, and fragmented. Despite a more comprehensive and integrated approach the government has adopted, given its limited resources, the reach will also be limited. First, the requirements for quality infrastructure and overall general connectivity are monumental. Reaching a critical mass and sustained momentum will take time, aside from requiring huge resources. Second, past and current efforts (e.g. one-town-one-product emulating Thailand) needed better coordination and implementation, and possibly some reforms, which the recent SME thrust (strategy) is trying to address. As already noted, there is also a crucial need for better data and statistics. Hopefully, the new approaches under a more integrated approach will be more effective and fruitful.

The Philippine strategy for SMEs outlined above, in effect, attempts to ‘mainstream’ MSMEs-- whether in the local value chain or the global value chain, whether as a supplier of goods and services, or as a user of intermediate inputs of goods and services. Mainstreaming SMEs could thus have two levels: (1) mainly local, (2) and global value chains. Again, while the government has already adopted a more comprehensive approach, it would take time to achieve across-the-board success, especially in terms of mainstreaming the majority of our SMEs in general, and linking our SMEs to the global value chain. Failures and bottlenecks are bound to persist. Furthermore, evidence of how much SME regional/global participation has been achieved is difficult to measure. Indeed, there is no solid and current measure about how much our SMEs are exporting. (Wignaraja et al, 2012)

Much of the perception of little or no progress comes from the stagnant composition and pattern of Philippine establishments and the persistent constraints and barriers found by many studies. (See above) However, perhaps the picture is not as gloomy if one looks at changes in labor productivity over time. Average growth in labor productivity has been negative in the 1990s, then turned positive during the next decade and has continued to rise

¹⁴ A continuous learning program for the development of micro, small and medium enterprises to become competitive in the domestic and international (global) markets.

dramatically during the first half of the 2010s. (see **Table 3**) To be sure, one cannot directly attribute this to success in the Philippine SME development efforts. For one, these are averages for all firms. Nonetheless, the trend provides a good sign about the performance of SMEs. After all, they comprise 99.6% of total number of establishments, more than 60% of employment and more than 36% of total value-added.

Period	Industry	Services
	in %	in %
1991-1999	-1.2	-0.8
2000-2009	1.9	1.4
2010-2015	2.9	2.4

Source of basic data: Philippine Statistical Authority

A more immediate goal for government is to mainstream MSMEs in the value chains, whether local or global. Over time, the distinction would disappear, as integration grows and linkages (and value chains) become more intertwined. In the meantime, the government could aim for higher goal of mainstreaming SMEs in the global value chains.

When SMEs are able to mainstream in the global value chains, the prospects and benefits are magnified, as these benefits redound to a larger economic system. SMEs that are mainstreamed in the international market generally perform better in terms of productivity, competitiveness, innovation and sustainable growth, compared to those dealing only with the domestic market. This could of course be a result of self-selection of firms that are able to participate. However, this could also be a result of a learning by doing effect and ‘on-the-job training’ as they would need to learn the ropes and deal with the more competitive market. In either case, whether a firm is ‘born global’ or evolved into one, the government should address bottlenecks and constraints, and provide a more conducive regulatory regime for SME participation in both the local and the global market (and the GVCs). Indeed, this is the thrust of the current SME development program, with its more comprehensive approach.

Mainstreaming of SMEs, in any level, is a common objective in APEC. It has become a major APEC cooperation area that has huge potential in achieving APEC’s goal of inclusive (and sustainable) growth. Such cooperation should ensure that regional economic integration would provide SMEs opportunities for greater participation in regional production networks. Cooperation could be in terms of exchange of information and best practice, mutual efforts to understand the problems and find solutions, establishing greater connectivity, linkages and networks. The next sections look at some evidence of mainstreaming of SMEs in the international market to gauge where the region (and the Philippines) is, and then the APEC initiatives to move the goal forward.

3. Evidence of mainstreaming SMEs in the international market

For this paper, mainstreaming SMEs in the regional and global market loosely refers to the internationalization of SMEs. In a nutshell, this means that these SMEs are able to engage in international business activities, that is, business activities that cross national borders. In general, there are four basic international business activities:¹⁵

- Trading: exporting and importing
- Licensing and franchising: acquiring and granting
- Strategic alliance and joint venture, and
- Foreign Direct Investment (FDI): outward and inward (donor and recipient)

Engaging in exporting and importing activities is the most basic and common international business activity. Indeed, the ability of a firm to export is the first indicator that is looked at to determine whether a firm can be categorized as an international enterprise. A major SME participation index often used in policy analysis is the proportion of firms that is able to export a portion of its sales, or the proportion of exports by SMEs in total exports. As it stands, there is a dearth of data on SME participation index, and exporting activity is already the most readily available. Interestingly, while the proportion of SMEs that import should be equally, if not more so, measurable, the SME participation index based on importing activities is even harder to come by.

From the little available data that we have seen, the common finding is the low level of SME participation in international activities. As far as exporting is concerned, Yuhua and Bayhaqi (2013) study for some APEC economies using data from the World Bank's Enterprise Surveys showed that the proportion of medium sized enterprises exporting directly or indirectly is less than 25 percent for most countries covered. Thailand and Malaysia posted the highest proportion of SMEs with around 41% and 55% respectively. The figure is around 16% for the Philippines. As earlier noted, in the case of Thailand, this could be due to its aggressive stance on FTA engagement. Malaysia comes second in this regard to Thailand in ASEAN. They are generally more export oriented, with higher export over GDP ratio.

The proportion of SMEs tends to be less, as the size of firms gets smaller. Indeed, the proportion of small enterprises able to export is less than 5% for many countries covered. See **Table 4**.

Table 4. Percentage of Firms Exporting Directly or Indirectly (at least 1% of sales)

Economy	Small	Medium	Large
Chile (2010)	4.4	12.4	33.5
Indonesia (2009)	1.6	14.2	55.3
Korea (2005)	7.4	33.3	52.9
Mexico (2010)	2.8	14.4	29.1
Malaysia (2007)	30	54.5	82.7
Peru (2010)	3.8	21.4	46.5

¹⁵ Business & Entrepreneurship - azcentral.com

Philippines (2009)	5	16.5	29.8
Russia (2012)	9.1	14.6	23.6
Thailand (2006)	40.7	58.3	89.5
Viet Nam (2009)	5.1	23.2	53.3

Note: Small firms (S): 5–49 employees; medium (M): 50–199 employees; large (L): above 200 employees.

The indicators are computed using data from manufacturing firms only.

Source: *The World Bank, Enterprise Surveys* (<http://www.enterprisesurveys.org>) Yuhua, Z. and Bayhaqi, A. 2013

It would have been equally useful to get statistics on import share of SMEs, or the proportion of SMEs that import. Being able to purchase intermediate inputs more readily from abroad is a clear indication that SMEs are engaged and mainstreamed. An indicator which shows the proportion of SMEs that export and/or import would be a better gauge of SME participation or mainstreaming in international market. In any case, whether exporting or importing, trade facilitation for SMEs is an important measure and APEC area for cooperation.

SMEs mainstreaming in the international market is not just through exporting or importing. This could also be in the form of a strategic alliance of two or more companies for mutual gain, e. g. a joint venture where the partners jointly establish a new company. Such joint market could be serving just the domestic market but is clearly internationally linked. The benefits from such cooperation are clear, especially for SMEs, where it would be able to share development and production costs, access technologies and sales networks. The policy handle here would involve improving the business and investment regulations, and in APEC, working toward regulatory coherence.

Along a similar vein, SME internationalization could be in the form of cross-border franchising activity. Franchising replicates a business success, with a clear process (formula) for obtaining technical know-how, training (which addresses lack of skills), and availability of capital and financing (addressing financial barrier). The owner of the concept or a business model (franchisor) allows another company (franchisee) to replicate the business according to the same concept, model, image and quality standards.¹⁶ The franchisor provides the franchisee with know-how, licenses and training. The franchisee would usually provide the investment, but in some cases, the franchisee and franchisor could establish a joint venture. Hence, franchising directly mainstreams the SMEs in the international market. The arrangement could also address most of the constraints faced by SMEs, particularly lack of skills and access to technology and know-how; and in the case of joint ventures, financial constraints as well. Classic examples of franchising are in fast food chains, hotel chains, car hire companies and retailing. In recent years, franchising activities have expanded to many business fields, big and small, in the goods and services sectors.

¹⁶ Jose de Caldas Lima, “*Patterns of Internationalization for Developing Country Enterprises (Alliances and Joint Ventures)*.” UNIDO 2008

Mainstreamed SMEs must also be part, at some level, of the global value chain and the global/regional production network. It is also thus useful to look at some evidence of participation of SMEs in production networks. In this regard, there are similar findings of low SME participation. Covering five ASEAN economies, Wignaraja (2012) confirmed that SMEs are still minor players in production networks as only 22 percent of SMEs participate within the production networks. Large firms are the major players in these networks with a participation ratio of 72.1 percent. See **Table 5**.

Table 5. Participation of SMEs and Large Firms in Production Networks (PN)

	All Countries	Malaysia	Thailand	Philippines	Indonesia	Viet Nam
Number of firms in PN	2203	646	619	352	206	380
PN firms as percentage of all firms, %	37.3	59.7	59.3	26.9	14.5	36.4
SMEs in PN (1-99 employees) as a percentage of all SMEs, %	22.0 ↓	46.2	29.6	20.1	6.3	21.4
Large firms in PN as a percentage of all large firms, %	72.1 ★	82.4	91.1	51.1	52.0	64.6

Source: Wignaraja (2012)

In an attempt to understand why some SMEs are able to participate in production networks and others are not, a study by Harvie, C., D. Narjoko, and S. Oum (2010) looked at some firm characteristics and examined the differences between SMEs in production networks (PN) and those not in PN. They integrated the data from the cross-country studies of the ERIA Survey on SME Participation in Production Networks at the end 2009 in most ASEAN countries (i.e., Thailand, Indonesia, Malaysia, Philippines, Vietnam, Cambodia, and Laos PDR) and China with 780 surveyed firms. The results, as expected, suggest that productivity, foreign ownership, financial characteristics, innovation efforts, and managerial/entrepreneurial attitudes are the important firm characteristics that differ between SMEs in and not in production networks. See **Table 6**.

Moreover, innovation appears to be a major factor. SMEs in production networks have superior characteristics in terms of their process innovation efforts. Innovative SME have better chances to participate in PNs (i.e. mostly process innovation such as improving business strategies). See **Table 7**.

Table 6. Average Value of Characteristics, SMEs Participating and Not Participating in Production Networks (PN)

Characteristics	In Production Networks	Not in Production Networks	Statistically Different
Size (employees)	66.2	52.1	Yes*
Age (years)	10.6	13.8	Yes**
Share of foreign ownership (%)	18.2	7.2	Yes**
Labor productivity (sales/employee, thousand USD)	26.8	23.0	No
Loan interest rate (%)	6.1	8.9	Yes**
Interest Coverage Ratio, ICR	250.0	77.5	Yes*
Credit interest rate (%)	6.2	8.9	Yes**
Distance to industrial parks or EPZs (hour)	1.0	0.9	No
Distance to port (hours)	1.3	1.2	No
Skill intensity	0.4	0.3	Yes**

Table 7. Innovation Effort Characteristics, Frequency (in %) of SMEs Participating and Not Participating in Production Networks

Characteristics	In Production Networks	Not in Production Networks	Statistically different
Met international standards (e.g. ISO, etc.)	44.4	36.5	Yes*
Introduced information and communication technology	35.5	36.0	No
Established new divisions or plants	27.0	18.8	Yes*
Involved in business network activities	52.6	47.1	No

Bought new machinery with new functionality	58.4	47.9	Yes**
Improving the existing machinery	72.5	59.1	Yes**
Introduced new know-how in production method	49.6	40.7	Yes*
Recently introduced new products	63.4	55.1	Yes*

Finally, while productivity, foreign ownership, financial characteristics, innovation efforts, and managerial/entrepreneurial attitudes are important determinants to SME participation, the ease in which SMEs could engage in any of the international activities mentioned (from trading to FDI) require a good regulatory framework that is SME-friendly. This includes quality infrastructure, trade facilitation and overall general connectivity. Unfortunately, the Philippines has not been faring well in many of these factors, especially in the area of logistics and infrastructure. Hopefully, the past reforms, which saw the Philippines improving in the global rankings could lead to better mainstreaming of Philippine SMEs.

4. APEC initiatives on SME Development

Within the context of the Asia Pacific Economic Cooperation Forum, SMEs have been recognized as a priority area since the 1993 APEC Leaders' meeting in Seattle. Since 1994, a year later, an SME Ministerial Meeting¹⁷ (SMEMM) has been held annually while the SME Working Group (SMEWG)¹⁸ Meetings have been done twice a year.

Over the years, a number of SME-related initiatives and activities has been developed and implemented: from the Action Program for Small and Medium Enterprises under the Osaka Action Agenda (OAA) in 1995; the preparation of the Integrated Plan of Action for SMEs (SPAN) in 1998; the series of Strategic Plans; the Daegu Initiative; the organization of the Joint SME-MRT Ministerial Meeting in 2011 to address top barriers to SME trade; as well as the Nanjing Declaration on Promoting Innovation and Sustainability.¹⁹

¹⁷ The 22nd APEC Ministerial Meeting on SMEs and related activities will be held on 21-25 September 2015 in Iloilo City, as part of the Philippine hosting of APEC 2015. Discussions will focus on the Boracay

¹⁸ First established in February 1995 as the Ad Hoc Policy Level Group on SMEs' (PLGSME), the objective was to assist SMEs improve their competitiveness and to facilitate a more open trade and investment environment. In 2000, the group was renamed the SMEWG and granted permanent status.

¹⁹ Some other important initiatives may be read from the Singapore Study on APEC SME Internationalization Best Practices; APEC Ease of Doing Business; APEC Business Travel Card; APEC Global Supply Chain

APEC efforts attempt to address the constraints that are not only relevant to the Philippines but to the APEC region as a whole. The key constraints echo those revealed in studies on Philippine SMEs. They include underdeveloped infrastructure; inadequate information especially regarding market opportunities across borders; and existing international trade policy frameworks and regulations that are less suited for the MSMEs; lack of facilities needed to comply with such border measures; limited access to competitively priced and internationally acceptable inputs; and lack of access to financing thus imposing significant barriers to MSME expansion.

To summarize, APEC programs have been wide-ranging-- from providing capacity building programs to facilitating access to financial services, and trade facilitation which would benefit SMEs most. Accordingly, APEC initiatives can be grouped into the following major areas: (1) Building Management Capacity, (2) Entrepreneurship and Innovation, (3) Finance, (4) Business Environment, Market Access and Internationalization. Worth noting are initiatives related to start-ups: the APEC startup Accelerator Program and a Mentorship Program. Another is the APEC Framework for SME Financing (initiated by ABAC Canada) which include among others: (1) promoting and implementing reforms to ensure a clear legal infrastructure for lending, (2) supporting fully transparent credit information systems to incentivize lenders to significantly expand more affordable credit to SMEs in the region, and (3) supporting a dialogue on these standards as part of the proposed Asia-Pacific Financial Forum (APFF) to align International Financial Reporting Standards (IFRS) principles with the interests of SMEs. The use of IT has also been identified as an area for cooperation. In this regard, ABAC China is sharing its best practice in using e-commerce as a catalyst for growth with its “All-in-One e-Commerce Platform – the new eco-System for SMEs in China.”

Some more specific examples of some of APEC initiatives include the following:

APEC Center for Technology Exchange and Training for SMEs (ACTETSME)²⁰

This was established under the auspices of the Philippines during the 1st APEC hosting in 1996. The objective is to foster and promote technology exchange and training among SME’s in the APEC region by providing relevant, authoritative, and accessible information to individual SME’s, organizations of SME’s, and agencies of governments mandated to promote and assist in the development of SMEs.

The **APEC SME Innovation Center** established in Korea in 2006 has provided advice to 96 companies in seven APEC economies. The APEC SME Innovation Center has two major goals: one is to help APEC member economies exchange information on SME

Event. A major effort outside of the SMEMM for MSMEs is the Boracay Action Agenda to Globalize MSMEs, which the Ministers Responsible for Trade, adopted in Boracay, the Philippines in May 2015.

²⁰ Recognize as Best practice program on access to information

innovation and the other is to establish cooperative networks among APEC members for SME innovation. To reach the goals, the Center will conduct research of policies and practices on SME innovation and identify the best practices. At the same time, it will build networks among stakeholders of innovation and hold training programs and conferences.

APEC SME Crisis Management Center

Chinese Taipei proposed the establishment of the "APEC SME Crisis Management Center" to the 2009 APEC SME Ministerial Meeting and Annual Ministerial Meeting, and obtained strong support. In the 2009 Annual Ministerial Joint Statement and SME Ministerial Statement, the Ministers have encouraged the establishment of the APEC SME Crisis Management Center. "To improve SMEs' crisis management capabilities" has also been identified by the 2009 Leader Declaration as an important task for APEC during the coming years. APEC Budget and Management Committee also agreed to sponsor the training workshop of 2009 held by the Center in Taipei.

APEC project on SME business Ethics

Beginning in 2011, the Asia Pacific Economic Cooperation (APEC) multi-year initiative on Business Ethics for SMEs has helped small and medium enterprises in the biopharmaceutical and medical device industries develop codes of ethics to self-regulate their business practices. Today, as a result of the APEC initiative, codes of ethics have been adopted and are undergoing implementation by around 60 biopharmaceutical and medical device industry associations and their member companies from 19 economies across the Asia-Pacific, representing more than 14,000 firms.

To support these initiatives, the SMEWG Strategic Plan for 2013-2016 was endorsed to provide a roadmap to address critical issues and concerns pertaining to the growth of SMEs and micro enterprises (MEs) in the APEC region along these priority areas. A valid criticism of APEC initiatives and Action Plans is how much these plans have been implemented and possible impacts. Unlike initiatives and cooperation in supply chain connectivity which gave concrete targets in reducing transaction costs, targets and achievements in SME developments are more difficult to quantify. Toward this end, the SME Working Group agreed to work together and provide four key indicators for the SME Monitoring Index to assess outcomes of the 2013-2016 Strategic Plan. These four indicators include: (i) SMEs share of GDP; (ii) SMEs share of total business population; (iii) SMEs contribution to employment; (iv) SMEs contribution to exports. These indicators are still inadequate in showing the impact on inclusive growth, but SME data availability is a huge problem for many countries.

5. Summary and Recommendations

NEDA Secretary Balisacan highlights²¹ "employment generation, product innovation through establishment of new industries, and countryside development as the immense

²¹ Rappler article entitled "Make SMEs mainstream, capture global markets – NEDA chief" published December 2014. <http://www.rappler.com/business/economy-watch/77413-mainstream-smes-balisacan-apec-isom>

multiplier effects that small and medium enterprises (SMEs) can do to the Asia-Pacific region.” However, despite the benefits from SMEs’ participation in GVCs and the international market, the desired outcome is not automatic. From the little available data, SME participation in international activities has been low. As far as exporting is concerned, the World Bank survey show the proportion in this regard is less than 5% for small enterprises and only around 12-25 % of medium enterprises for most of the APEC economies covered. Covering five Asian economies, Wignaraja (2012) finds similarly that SMEs are still minor players in production networks as only 22 percent of SMEs participate within the production networks.

These findings reveal the constraints and barriers to SMEs, both internal and external. These constraints are well known and have been what the various APEC activities on SMEs try to address. Internal factors include lack of access to technology, skills and finance. At the same time a host of external factors such as poor physical infrastructure and a complex legal and regulatory framework limit the ability of SMEs to thrive. In particular, these barriers limit the capability of SMEs to participate more actively and effectively in the international market.

In sum, the APEC priorities to address these SME barriers and constraints can be grouped into: (1) Building Management Capacity, (2) Entrepreneurship and Innovation, (3) Finance, (4) Business Environment, Market Access and Internationalization. The SMEWG Strategic Plan for 2013-2016 was endorsed to provide a roadmap to address critical issues and concerns pertaining to the growth of SMEs and micro enterprises (MEs) in the APEC region along these priority areas. Various APEC activities on SMEs have covered a wide range of practical measures under these priority areas.

SME development is a key objective of many developing economies. On its own, the Philippines has sought to address the problems and constraints which have become more complex with globalization and technological change in terms of both challenges and opportunities. Within this more complicated, globalized context, the need to mainstream SMEs has become more urgent, especially for benefits to have wider reach and for growth to be more inclusive. Fostering SME participation in the international market is a difficult endeavor for many developing economies, like the Philippines, to do on its own. Bringing this to the APEC agenda as a priority area for cooperation benefits not just the individual countries but the region as a whole.

The APEC work on SMEs should be sustained, and possibly enhanced. New initiatives should continue to be developed. Possible areas for cooperation could focus further on the business environment and regulatory framework which is especially burdensome for SMEs and MEs. A promising practical initiative from the Philippines is promoting trade facilitation for SMEs. A concrete proposal in this regard is raising the threshold value of imports that would be exempted from customs duties, taxes and other documentary fees. In a similar vein, APEC economies with FTAs should be encouraged to raise the threshold where Certificate of Origin (CO) is waived. Another possible area for cooperation and further work is the creation of an APEC Trade Repository. This could be an expansion of the ASEAN Trade Repository initiative to cover all APEC member economies.

Other possible areas include seeking concrete measures in aligning IFRS with SMEs interest. This could involve developing a more suitable, standard accounting system and books that are less complex for SMEs to comply with, but credible and informative enough about the SME (and ME) credit status and standing needed in both international or local transactions. Related to this, advancing financial literacy in SMEs is another possible area. This could entail education and technical programs across economies. Efforts along these lines would encourage SMEs to become better versed and more capable in dealing with the intricate business environment and regulatory framework. These would help mainstream SMEs in the supply and value chain within and outside the local economy.

Another possible additional stimulus for SMEs could be APEC cooperation in facilitating franchising activities. Cross-border franchising directly internationalizes (mainstreams) SMEs. In addition, franchising (local or cross-border) could address most of the constraints faced by SMEs, particularly lack of skills and access to technology and finance.

Finally, the need for more data cannot be overemphasized. This has handicapped APEC cooperation and individual economies in addressing problems and finding more effective solutions and monitoring and evaluating programs and policies.

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